

A Comparative Analysis of Predatory Pricing

Dissertation submitted in partial fulfillment of the degree of Master of Commercial
Law, University of Cape Town

Rune Løland

LLNRUN001

Supervisor: Karin Lehmann

Word Count: 20133

September 2013

The copyright of this thesis vests in the author. No quotation from it or information derived from it is to be published without full acknowledgement of the source. The thesis is to be used for private study or non-commercial research purposes only.

Published by the University of Cape Town (UCT) in terms of the non-exclusive license granted to UCT by the author.

Declaration

Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Master of Commercial Law in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of Master of Commercial Law dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Signed: signature removed this 13 day of September 2013.

Acknowledgements

I owe a big thank you to the following people:

To my supervisor, Karin Lehmann, for taking on this task and for providing guidance and valuable input on my dissertation; to my parents for their continued support in everything I do; and finally to my girlfriend Catriona Brophy for all the support throughout the process of writing this dissertation.

University of Cape Town

Abstract

The ban on predatory pricing is a contested subject. Nevertheless, most competition law jurisdictions have legislation regarding bans on predatory pricing. This is also the case for new competition law regimes. There are two major influences on the way predatory pricing is tackled, namely the EU approach and that of the US. This dissertation will focus on these two approaches, by studying how the ban on predatory pricing is legislated and practiced by the courts in the respective jurisdictions. The aim is to define clear rules for the ban on predatory pricing both in the EU and the US, and to identify any differences between the two approaches. Furthermore, the ban on predatory pricing will be studied through a political and historical lens, in an attempt to explain why the ban is practiced the way it is in the respective jurisdictions, and to better understand the differences between them. Last, but not least, the dissertation will examine which approach is better suited for developing countries implementing predatory pricing legislation. The 'new' South African Competition Act will be used as an example; through an examination of its influences and the effects those influences had on the wording of its provisions regarding predatory pricing.

Table of Contents

1. INTRODUCTION	1
1.1. Background	1
1.2. Why is predatory pricing considered harmful for competition?	3
1.3. Essential features of predatory pricing	5
2. PREDATORY PRICING IN THE EU	7
2.1. Article 102 Treaty on the Functioning of the European Union (TFEU)	7
2.1.1 <i>Dominant position and market definitions</i>	8
2.1.2 <i>Abusive conduct – a general overview</i>	12
2.2. EU Predatory Pricing case law	17
2.2.1. <i>AKZO Chemie BV v. Commission</i>	17
2.2.1.1. Background and outcome of the AKZO case	17
2.2.1.2. Conclusions from the AKZO case	19
2.2.2. <i>Tetra Pak International SA v. Commission</i>	21
2.2.2.1. Background of the Tetra Pak case	21
2.2.2.2. Conclusions from the Tetra Pak case	23
2.3. Conclusions	24
3. PREDATORY PRICING IN THE US	25
3.1. The Sherman Act	25
3.2. US Case Law	29
3.2.1. <i>Utah Pie Co. v. Continental Banking Co.</i>	30
3.2.2. <i>Matsushita Electric Industrial Co. v. Zenith Radio Corp</i>	31
3.2.3. <i>Brooke Group Ltd v. Brown & Williamson Tobacco Corp</i>	32
3.3. Conclusions	34
4. DIFFERENCES BETWEEN THE EU AND THE US APPROACH TO PREDATORY PRICING	35
4.1. Key differences	35
4.2. Reasons for the differing treatment of predatory pricing in the EU and the US	37
4.2.1. <i>Introduction</i>	37
4.2.2. <i>EU Competition law in a historic perspective – ordoliberalism</i>	39
4.2.3. <i>US competition law in a historic perspective – Chicago School</i>	42

4.2.4. <i>Conclusions</i>	44
5. CRITICISM OF THE BAN ON PREDATORY PRICING	45
5.1. Introduction	45
5.2. Common criticism	46
5.3. Why is the ban against predatory pricing still practiced?.....	48
6. PREDATORY PRICING IN SOUTH AFRICA	49
6.1. The Competition Act	49
6.1.1. <i>Section 8(d)(iv)</i>	50
6.1.2. <i>Section 8(c)</i>	52
6.2. Cases regarding predatory pricing in South Africa	52
6.3. Historical influences and comparison	54
6.4. Conclusions	55
7. CONCLUSIONS.....	56
 BIBLIOGRAPHY.....	 58

1. INTRODUCTION

1.1. Background

This dissertation explores the topic of predatory pricing generally, and more specifically, seeks to compare its differing applications in the EU and the US, with a view to determining which approach would be better suited in the case of emerging economies such as South Africa. Predatory pricing is a long-standing feature of EU and US competition law, and can in a simplistic way, be defined as the way in which a business sells its goods at such low prices that other companies can no longer compete and are forced to cease selling similar goods.¹ In other words, predatory pricing occurs when a large firm sets its prices very low, often below its production costs, with the intention of forcing competitors out of the market so that it can establish a monopoly-like position and charge higher prices in the future in an attempt to recoup its losses and profit in the long run.²

As this dissertation will demonstrate, there are several important pre-conditions necessary to execute a successful predatory pricing scheme. The most obvious one however is that it requires the company attempting a predatory pricing scheme, hereafter referred to as the predator, to have a certain amount of market power.³ In simple terms, having market power means having the ability to set a higher price, or to sell at a lower quality, than the other firms in the market and still be profitable in the long run.⁴ This long term profitability requires that the predator is able to recoup its potentially substantial losses after selling its products or services at a deficit.⁵

¹ Oxford Dictionary, 8th edition.

² Director of Investigation and Research 'Predatory Pricing Enforcement Guidelines' (1992).

³ This is a direct result of the dominance-requirement in Article 102 TFEU for the EU, and under Section 2 of the Sherman Act in the US. Ref. sections 2 and 3 of this dissertation.

⁴ See for instance P 'Nelson Monopoly Power, Market Definition and the Cellophane Fallacy' at 2.

⁵ As this dissertation will demonstrate, such recoupment is necessary to prove to be found guilty of predatory pricing in accordance with Section 2 of the Sherman Act in the US. The EU does not have a similar requirement, but it is nevertheless believed that the hope of recoupment is the greatest incentive for a company to embark on a predatory pricing strategy.

As this dissertation will point out, the ban on predatory pricing is considered by many to be controversial.⁶ Nevertheless, most developed and developing countries worldwide have legislation under competition law that prohibits predatory pricing, as it is considered to cause harm for competition.⁷ By far, the two most influential authorities on predatory pricing, and indeed competition law in general, are the US and the EU. This is a natural consequence of their position as the two most significant trade blocks in the world. The two approaches follow two different directions; where the European approach can be argued to be quite hands-on with fairly substantial interference, the US approach is more Darwinian and interferes less in competition.⁸ Other countries' competition laws are often inspired by one of these approaches, as will be demonstrated when assessing the South African approach in section 6.

This dissertation aims to compare the two approaches, in order to ascertain whether there are any theoretical differences and how these differences translate to the practical application of the principle. A secondary objective is to try and understand and explain these potential differences, and why they exist. Last, but not least, the intention is to draw a conclusion as to which approach is better-suited to emerging economies implementing competition laws. The regulation of, and influences on the South African Competition Act of 1998 will be used as an example in this regard.

The following sections under this Chapter one will explain why predatory pricing is considered to be detrimental for competition,⁹ and look at some general, essential features of predatory pricing,¹⁰ in order to provide a better understanding of the concept of predatory pricing.

In Chapter 2, the dissertation will carry out an in-depth analysis of the legislation and case law regarding predatory pricing in the EU. The same will be done for the US

⁶ See Chapter 5 of this dissertation.

⁷ For Article 102 TFEU for the EU; Section 2 of the Sherman Act for the US; Section 8(d)(iv) of the Competition Act 89 of 1998 for South Africa; § 46(1) of the Trade Practices Act for Australia; Article 21(18) of law 8884 of June 11, 1994 for Brazil; § 4(2)(ii) of the Competition Act, 2002, No. 12 of 2003 for India; etc.

⁸ See elaboration in Article 2 to 4 of this dissertation.

⁹ Section 1.2

¹⁰ Section 1.3

approach in Chapter 3. Chapter 4 will summarize and evaluate the most important differences, and explain these differences in an economic and political perspective. Since the regulation of predatory pricing is a contested one,¹¹ Chapter 5 will focus on the most common skepticism directed at the ban of this pricing scheme.

Finally, Chapter 6 of the dissertation will draw study the ban on predatory pricing in South Africa, and draw conclusions as to which approach is better suited for, and has influenced, emerging economies such as South Africa.

1.2. Why is predatory pricing considered harmful for competition?

It is a common notion that competition laws exist to protect competition, and not the competitors themselves. Competition is desirable and worthy of protection because of its numerous advantages. First and foremost, competition promotes what is known as consumer welfare. 'Consumer welfare', in this context, refers to the benefits that accrue to individuals as a result of the utilization of goods and services.¹² Consumer welfare is enhanced through competition because competition encourages manufacturers and service providers to be more efficient¹³ by way of better responding to the needs of their customers, as well as encouraging them to be innovative, to initiate and to venture.¹⁴ In other words, competition forces the competitors to optimize their resources, which leads to increased consumer welfare through lower prices and better quality.¹⁵

¹¹ See for instance J McGee 'Predatory Price Cutting: The Standard Oil (N.J.) Case' *Journal of law and Economics* 1 (April 1958): 13760, H Demsetz 'Barriers to Entry' *American Economic Review* 72 (May 1982), F Easterbrook 'Predatory Strategies and Counterstrategies' (1981) *University of Chicago Law Review* 48, T J DiLorenzo, 'The Myth of Predatory Pricing' (February 1992) *Cato Policy Analysis* No. 169.

¹² Definition from Organisation for Economic Co-operation and Development (OECD).

¹³ 'Efficiency' in this sense is defined as the total gains of trade.

¹⁴ S Vaknin 'Competition Laws'.

¹⁵ *Ibid.*

Moreover, competition also gets rid of the failures through a natural elimination process; in order to survive in a competitive market, the competitors need to constantly improve and become more efficient, or risk losing out.¹⁶

From a macroeconomic perspective, competition is desirable because it ensures that the resources are allocated and exploited in an efficient way. This will in turn generate benefits for consumers by guaranteeing that they pay the lowest possible price, while still retaining the highest possible standard, of goods and services.¹⁷ Competition laws are made to protect this unfettered competition.

There is a broad consensus that predatory pricing can have a detrimental effect on competition, and is consequently illegal in many jurisdictions. For instance, harm could occur if a company prices its goods or services so low that it would be unprofitable for competitors to stay in the market, and then increases prices to supra-competitive levels for a significant period of time afterwards.¹⁸ A potential short term benefit for the consumer while the predatory pricing is ongoing can thus turn into an overall loss in the long run after the competition has been eliminated or substantially reduced.¹⁹ Furthermore, competition authorities worry that predatory pricing may eventually lead to monopolies or monopoly-like situations, where a company has virtually no competitors.²⁰ Monopolies are undesirable and considered bad for competition because they restrict free trade, preventing the setting of prices by the market itself.²¹ In other words, a company holding a monopoly can, to a great extent, dictate the market, and is free to charge higher prices and lower quality than in a competitive market. This will lead to a less efficient use of the resources, and a reduction in consumer welfare.

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ Areeda & Hovenkamp *Antitrust Law* 2ed (2002) at 272.

¹⁹ Sherman Act Section 2 Joint Hearing: 'Predatory Pricing' (22 June 2006) *Hr'g Tr.* 30.

²⁰ The fear of monopoly is explicitly reflected in the ban on predatory pricing in the US, where the ban on predatory pricing is found under the ban on attempt to monopolize in section 2 of the Sherman Act.

²¹ K Amadeo 'Monopoly' available at <http://useconomy.about.com/od/glossary/g/monopoly.htm>.

With this in mind, it is hard to imagine motives for profit-maximizing companies to pursue a predatory pricing scheme other than a desire to drive competitors out of the market, or prevent new competitors from entering the market.²²

It is the competition authorities' role to draw the line between legal competitive behavior and predatory pricing. As this dissertation will later demonstrate,²³ the criteria for predatory pricing differ from jurisdiction to jurisdiction. There are, however, some key features that are essential to predatory pricing in general. These will be further elaborated on in the next section.

1.3. Essential features of predatory pricing

As this dissertation will argue, there are differences between the EU and US way of regulating and practicing the ban on predatory pricing. There are, however, some key features that are essential to predatory pricing in general and thus common to both approaches.²⁴

First and foremost, the market structure must allow for predatory pricing in the situation in question. In other words, an assessment of the market concentration must be undertaken. 'Market concentration' refers to the number and the size of the participants in the market. In order to execute a predatory pricing scheme, the predator must have a dominant position in the market, and there must be a limited number of competitors. A market where these properties exist is a concentrated market. The more concentrated the market is, the more likely the possibility of a successful predatory pricing scheme.

A feature of a concentrated market is the presence of entry barriers. If there are low entry barriers to the market, there is a relatively high possibility that new competitors

²² This was also the stance taken by the court in the EU case C-62/86 *AKZO Chemie BV v Commission* section 71. See also section 3.2.1. of this dissertation.

²³ See for instance comparison of EU and US approach in Chapter 4 of this dissertation.

²⁴ This section is loosely based on V Siraj 'It's all dominance that's crucial in Predatory Pricing' available at <http://www.legalserviceindia.com/article/I267-Predatory-Pricing.html>.

will enter the market once the old competitor is driven out.²⁵ As a result, a dominant company will be reluctant to commit to predatory pricing no matter how strong a position it holds in a market; if there is a high possibility for new companies to establish themselves in the market, it will experience difficulties in recouping its losses, and predatory pricing is unlikely to be worth the risk.

Another important feature necessary for predatory pricing is excessive capacity. When reducing prices in order to take over the competitor's customers or clients, the predator must be able to produce items or supply enough services to meet the market's demand.²⁶ If the predator does not have this excess capacity it would not be able to absorb the competitors' business effectively and, as a consequence, the predatory pricing scheme would not be successful.

Furthermore, the predator must have deep pockets. Simply put, the predator must have the economic muscles necessary to pull off a predatory pricing strategy.²⁷ Only companies with large financial reserves, capable of losing money for a considerable amount of time from selling their products or services at a lower price than its average variable costs,²⁸ or at least below their average total costs, will have a chance to succeed.

Lastly, the predator must be able to recoup its losses once its competitors are driven out of the market. Recoupment in this sense means the ability to regain the short term losses from the excessive pricing once it has obtained a monopoly-like position in the market.²⁹ Without the possibility of recouping its losses, the predatory pricing would be senseless. As this dissertation will demonstrate, different jurisdictions have different requirements when it comes to proof of recoupment. Despite the differing practices when considering possible recoupment, both jurisdictions nevertheless seem to acknowledge that possible recoupment is an important incentive for the company

²⁵ *Ibid.*, paragraph 5.

²⁶ *Ibid.*, paragraph 6.

²⁷ *Ibid.*, paragraph 7.

²⁸ See section 2.2.1 of this dissertation for more details.

²⁹ *Supra* n. 24 paragraph 8.

undertaking a predatory pricing scheme. Hence, this feature is, in this context, a particularly important one.³⁰

The features mentioned above are only likely to be possessed by companies who have a dominant position in the relevant market. Thus, dominant position is also listed explicitly as a necessary condition in EU competition law. This is not the case in the US, although practically speaking it is also a prerequisite for predatory pricing here.³¹

Although these prerequisites are jurisdiction-unspecific, there are, as this dissertation will demonstrate, a couple of significant differences in the regulation of the ban on predatory pricing. Consequently, the following section, focusing on the EU, will carry out an in-depth analysis of how the ban on predatory pricing is regulated by law, and how this regulation is practiced by the courts. The same will be done for the US in chapter 3. Chapter 4 will compare the two and identify the differences in the treatment of the ban, and the reasoning behind these differences. Eventually, the conclusions from these analyses will be used to ascertain their influences on the regulation of predatory pricing in the South Africa.

2. PREDATORY PRICING IN THE EU

2.1. Article 102 Treaty on the Functioning of the European Union (TFEU)

The ban on predatory pricing in the EU is regulated by Article 102 TFEU.³² This article in its entirety reads:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist of:

³⁰ See Chapter 4 of this dissertation.

³¹ Section 4.1 of this dissertation.

³² Article 102 TFEU is the same as the previous Article 82 (and before that, Article 86) of the EC-treaty. For the sake of consistency, this dissertation will refer to Article 102 TFEU regardless of the time frame and thus Article, under which the respective cases were reviewed.

- (a) Directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) Limiting production, markets or technical development to the prejudice of consumers;
- (c) Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) Making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Of most relevance here is paragraph (a), since predatory pricing is considered an unfair pricing strategy. There are two prerequisites for the application of paragraph (a); firstly, that the alleged company holds a 'dominant position' in the relevant market, and secondly, that it has exercised an 'abuse' of this dominant position.³³ These conditions are thus essential requirements in order to raise a predatory pricing challenge and therefore warrant a closer analysis.

2.1.1 Dominant position and market definitions

Dominance is the fundamental requirement under Article 102 TFEU. It is only a 'dominant' firm that can commit predatory pricing, since considerable strength is necessary to pull it off. The challenge is that determining whether a firm is 'dominant' is itself a difficult and uncertain exercise. What it means to hold a 'dominant position' will consequently be studied closer in this section.

Various definitions of dominance have been offered, but the European Court of Justice (hereinafter referred to as the Court) has stated that a dominant position:

'... relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent

³³ Article 102 TFEU first paragraph.

independently of its competitors, its customers and ultimately of the customers'.³⁴

Although the definition captures the essence of what a dominant position is, it can, in some cases, be hard to determine whether or not a company actually holds a dominant position. Independence seems however to be a key factor; the greater the extent to which a company can act independently of its competitors, the greater its degree of dominance. The main indicator of this dominance is the company's market share, since only a company which has won a large part of one market can be deemed to be in a dominant position.³⁵

According to the Court, a market share of 75 per cent or more leads to an irrebuttable presumption of dominance, and no further investigation is deemed necessary.³⁶

Moreover, a market share between 40 per cent and 55 per cent is enough to indicate a dominant position, as long as other factors are present.³⁷ These factors can translate into different types of 'market power'³⁸ which can help in determining whether a company holds a dominant position or not. These factors are usually related to the properties of the relevant market and that of the other companies in the market.

One such factor can be 'barriers to entry' or 'entry barriers'.³⁹ Although a vague term with no clear definition in relation to competition law,⁴⁰ the existence of 'entry barriers' suggest that there are some circumstances which hinder new companies entering the market.⁴¹ Such hindering factors can for instance be economic, social, contractual

³⁴ Definition introduced in Case 27/26 *United Brands v Commission*, section 25, but repeated several times in later cases.

³⁵ C Bellamy and G Child *European Community Law of Competition* (2001) at 201.

³⁶ Case 85/76 *Hoffman-La Roche v. Commission* section 41, 53 to 56, 59 to 60, 67.

³⁷ Case 27/26 *United Brands v. Commission* section 108 to 129, *Supra* n. 36 section 50 to 52 and 61 to 63, Case 62/86 *AKZO v. Commission* section 60.

³⁸ 'Having 'market power' implies that the company has the power to influence or alter a market by its actions.

³⁹ OECD Policy Brief Competition and Barriers to Entry, third paragraph, available at <http://www.oecd.org/competition/37921908.pdf>. See also section 1.3 third paragraph of this dissertation.

⁴⁰ *Ibid.*, third paragraph.

⁴¹ A Sullivan and S M Sheffrin *Economics: Principles in action* (2003) at 15.

commitments, lack of information etc.⁴² The higher the entry barriers, the more difficult it is for new actors to establish themselves in the market, and the stronger the market power of the alleged dominant company.⁴³

Another factor useful in determining dominant position is the market structure, i.e. the market share of the closest rivals.⁴⁴ A significant gap between the market share of the presumed dominant company and the next largest competitor may confirm the existence of a dominant position.⁴⁵ For instance, a company with a market share of 45 per cent is highly unlikely to be held as a dominant one, if its closest competitor had a market share of 40 per cent.

An example of a company found to hold a dominant position in a market despite having a relatively low market share, is found in *Hoffman-La Roche*.⁴⁶ In this case, a market share of 47 per cent was enough to establish a dominant position in a market, when its biggest competitor had a market share of 27 per cent.⁴⁷ In this particular case, however, an important factor was that, along with holding a greater market share, the company's technology was considered superior to the one of its competitors. The judge stated that:

'An undertaking which has a very large market share and holds it for some time, by means of the volume of production and the scale of the supply which it stands for – without those having much smaller market shares being able to meet rapidly the demand from those who would like to break away from the undertaking which has the largest market share – is by virtue of that share in a position of strength which makes it an unavoidable trading partner and which, already because of this secures for it, at the very least during relatively long

⁴² A Eberhard 'European Competition Law: A critical Analysis of the Process Employed by the Commission to Assess Dominance under Article 82 EC' (2006) *Hanse Law Review* at 225 to 226.

⁴³ It can be mentioned that some commentators in recent years have argued that - although having theoretical interest - defining entry barriers is irrelevant to competition policy, ref. OECD Policy Brief Competition and Barriers to Entry, third paragraph, available at <http://www.oecd.org/competition/37921908.pdf>. The Commission, however, still lists barriers to entry as an indicator of dominant position, see Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law *Official Journal of the European Communities* C 372/5 section 24. A further analysis of this issue falls outside the scope of this dissertation.

⁴⁴ *Supra* n. 35 at 705.

⁴⁵ *Supra* n. 42 at 225.

⁴⁶ Case 85/76 *Hoffman-LaRoche v Commission*.

⁴⁷ *Ibid.*, section 41.

periods, that freedom of action which is the special feature of a dominant position'.⁴⁸

In other words, the Court found that although the defendant in this case did not have a very large market share, other factors indicated that it still had much power in the market, and was thus found to be in a dominant position.

In general, it is acknowledged that the higher the market share, the less important are factors such as entry barriers and rival's market share etc., and vice versa. In other words, determining dominance is a dynamic process. As this dissertation will later demonstrate,⁴⁹ the requirement of proving abuse will be stricter when the dominant position is not very strong, and the converse is also true.⁵⁰

Additionally, it is a requirement that the undertaking in question holds a dominant position 'within the common market'.⁵¹ 'Market' refers to both product/service market and to a geographic market.^{52 53} A relevant product market 'comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.'⁵⁴ In other words, both the products' physical characteristics and subjective elements may be of relevance.

Relevant geographic market, on the other hand, encompasses the area wherein the undertakings in question engage in 'the supply and demand of products or services' and further, where 'the conditions of competition are sufficiently homogenous and which can be distinguished from neighboring areas because the conditions of competition are appreciably different in those areas.'⁵⁵ A geographical market is not

⁴⁸ *Ibid.*

⁴⁹ Section 2.1.2.

⁵⁰ See section 2.1.2 and 2.2.

⁵¹ Article 102 TFEU first paragraph.

⁵² Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law *Official Journal of the European Communities* C 372/5.

⁵³ Market may also comprise 'Temporal Market' which is the time dimension, but is rarely of practical relevance. For more information, *supra* n. 52 chapter II.

⁵⁴ *Supra* n. 52 section 7.

⁵⁵ *Supra* n. 52 section 8.

necessarily the entire Common Market, but might be reduced to a 'substantial part' thereof.⁵⁶

In conclusion, a company must have a minimum market share of at least 40 per cent in the relevant product and geographical market, provided that its competitors are small and there are high barriers to enter the market. The criteria for determining dominance are however, vague, and rely to a great extent on how broadly or narrowly the relevant market is drawn. Consequently, dominant position is hard to predict and is decided on a case-to case basis.

2.1.2 Abusive conduct – a general overview

Holding a dominant position in a market is not, in itself, illegal. What is illegal, however, is when a company abuses its dominant position. The wording 'any abuse' in the first paragraph of Article 102 TFEU is a complex one and merits further clarification. The article lists several ways to abuse a dominant position, particularly the four categories in subsections (a), (b), (c) and (d). These cover abusive behavior such as discriminatory pricing, excessive pricing, refusal to deal, loyalty rebates, tying, requirements and exclusive dealing contracts as well as predatory pricing, which is covered by subsection (a).

Abuse of a dominant position may however also consist of abusive conduct other than that listed above, note the wording 'such abuse may, in particular, consist of' in Article 102 TFEU. The perhaps most extreme example of supposed abusive behavior, is when dominant companies have been found to be in breach of their so-called 'special responsibility' not to distort competition⁵⁷, which will be elaborated on later on in this section.⁵⁸ Beyond this, there is little open to interpretation in the wording of Article 102

⁵⁶ *Supra* n. 42 at 223, with referral to C Bellamy and G Child *European Community Law of Competition* (2001) at 702.

⁵⁷ Mentioned for the first time in Case 322/81 *Michelin v Commission*, section 57. It is noteworthy that these forms of abuse were discussed under the dominance- requirement, but ever since it has been discussed under the abuse- requirement. *Supra* last paragraph of this section.

⁵⁸ See last paragraph of this section 2.1.2.

TFEU. Some further guidance can be found in the EU case law, where a frequently used definition has held that:

‘The concept of an abuse is an objective concept relating to the behavior of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition’.⁵⁹

This is a very general definition which leads to many new questions. Three key elements for assessing abuse may however be identified:

- i) The assessment of abuse is an *objective* one;
- ii) The conduct in question must be differentiated from ‘*normal competition*’; and
- iii) The conduct must have the effect of hampering the growth of existing market-place competition, or indeed, even of inhibiting the preservation of the current level of competition.

These elements that together constitute abusive behaviour are important ones when assessing an Art. 102 TFEU situation, and warrant closer analysis.

First and foremost, an abuse in this context is an objective concept – intent is not a requirement.⁶⁰ The EU court has furthermore explicitly stated that it is in the nature of the concept of abuse that a dominant company’s actions can be considered to be abusive even if intent is not evident.⁶¹ This principle must however be somewhat modified, as the EU court in some instances has accepted that intent is relevant.⁶² The AKZO test, a test developed by the Court in the case by the same name, can serve as an

⁵⁹ Definition introduced in Case 85/78 *Hoffmann-La Roche v Commission*, section 91, but repeated many times since, for instance in T-229-97 *Irish Sugar v Commission*, section 111 and T-219/99 *British Airways v Commission*, section 241.

⁶⁰ Explicitly stated in C 6/72 *Continental Can v Commission* section 29.

⁶¹ T-65/89 *BPB Industries Plc and British Gypsum Ltd v Commission*, section 70. This is also mentioned in E Osterud *Identifying Exclusionary Abuses by Dominant Undertakings under EU Competition Law* (2010) at 40.

⁶² See for instance the assessment of abuse in Case 62/86 *AKZO Chemie BV v Commission*.

example.⁶³ In this case concerning predatory pricing, it was held that if a price is higher than the variable costs, but lower than the total costs,⁶⁴ intent has to be proven to establish attempt of predatory pricing.⁶⁵ This is in contrast to a situation where the prices are below average variable costs, because there is no conceivable economic purpose for such prices other than the elimination of a competitor, since each item produced and sold entails a loss for the undertaking. Consequently, the courts distinguish between different situations, and accept that sometimes the objective test is appropriate and at other times intent is required.

The second key element of the above mentioned definition is that abuse implies the use of ‘methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators’. In other words, a line is drawn between ‘normal competition’, which is always considered legal, and ‘abnormal competition’, which is considered abusive, if it has an anticompetitive effect.⁶⁶ The question thus becomes what is considered ‘normal competition’.

The Court has not provided any definition of ‘normal competition’, or any guidance on how to interpret this. What seems clear however is that the terminology allows the dominant undertaking a certain leeway to take measures in response to competition in the market.⁶⁷ Furthermore, it is sensible to interpret that competitive behavior that is common in a particular market must be considered legal. As will be demonstrated later

⁶³ Case 62/86 *AKZO Chemie BV v Commission*.

⁶⁴ The AKZO test is a test developed by the Court in Case 62/86 *AKZO Chemie BV v Commission*.

⁶⁴ Case 62/86 *AKZO Chemie BV v Commission*. For a detailed description of the AKZO test and the meaning of average variable costs and average total costs, see the case analysis in section 2.2.1. of this dissertation.

⁶⁵ *Ibid.*, section 72.

⁶⁶ E Osterud *Identifying Exclusionary Abuses by Dominant Undertakings under EU Competition Law* (2010) at 40.

⁶⁷ O Kolstad *Norsk Konkurranserett Bind I Atferdsregler og strukturkontroll* (2007) at 366. This starting point may however be modified in light of *France Telecom v Commission* (previously *Wanadoo*) where it was held that France Telecom was not allowed to meet its competitor’s competition by implementing the same measures as its competitor. The reason behind this was the doctrine of the dominant company’s *special responsibility*, and it was held that ‘undertakings in a dominant position may be deprived of the right to adopt a course of conduct or take measures which are not in themselves abuses and which would even be unobjectionable if adopted or taken by non-dominant undertakings’ see section 186.

on in this dissertation this is however not necessarily the case, since cases regarding the special responsibility doctrine have concluded that abusive misconduct can exist even where common, normally accepted behavior has been exercised.⁶⁸ It has been claimed that the term 'normal competition' in *Hoffmann- La Roche* is the result of a bad translation in the English version of the case.⁶⁹ Whatever the reason, the Court has modified the definition of abuse somewhat in *Michelin I*, where it is stated that 'normal competition' means '... normal competition in products and services based on traders' performance'⁷⁰ Based on this statement, normal competition based on the trader's performance cannot be seen as abusive according to Article 102 TFEU.

How this rule has been practiced by the Court has varied, but has often been referred to as 'competition on the merits'.⁷¹ This means that dominant companies are free to compete with, and to outperform, their competitors as long as they are competing on the merits. This standpoint however, requires clarification as it has recently been stated that a dominant company can only compete on the merits as long as it is not in breach of its special responsibility not to distort competition.⁷²

The third element regarding the traditional definition of abuse, concerns the precise meaning behind the phrase '... the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition'. Since a negative effect for the consumers is not listed as a requirement for determining abuse, a natural interpretation is that the behavior must have an effect on competition to be considered abusive. In other words, it is the residual competition in the market that is decisive of what constitutes abuse. In a highly concentrated market with limited competition, even minor measures taken by the dominant company can have

⁶⁸ This was found to be the case in for instance C-395/96P and C-396/96 *Compagnie maritime belge transports v Commission*.

⁶⁹ *Supra* n. 66 at 41, and J Kallagher & B Sher 'Rebates revisited: Anti-competitive Effects and Exclusionary Abuse under Article 82' (2004) *European Competition Law Review* 25, no. 5 at 270.

⁷⁰ C-322/81 *Michelin v Commission* section 70.

⁷¹ For instance in T-228/97 *Irish Sugar v Commission* section 11, T-65/98 *Van den Bergh Foods Ltd v Commission* section 157, T-203/01 *Michelin v. Commission* section 97 and T-201/04 *Microsoft v Commission* section 1070.

⁷² Mentioned in T-65/98 *Van den Bergh Foods Ltd v. Commission* section 158 to 159.

considerable consequences for the competitiveness in the market. The potential of a dominant undertaking to cause significant damage, increases with the market share. Hence, the bigger the market share, the more stringent the assessment of abuse. A dominant undertaking with a market share of 90 per cent will thus be subject to a stricter assessment standard than a dominant undertaking with a market share of, for instance, 50 per cent.⁷³

One area where this 'effect on competition' element of the abuse definition is particularly evident is in the cases regarding the dominant companies' 'special responsibility' not to distort competition.⁷⁴ The doctrine of 'special responsibility' relates to the effect that dominant undertakings' actions have on the residual competition in the market. The Court has decided that the damaging effect dominant companies' might have on competition can cause them to be in violation of Art. 102 TFEU.⁷⁵

There are no pre-defined criteria for when a dominant company is in breach of its special responsibility not to distort competition. Rather, the Court has held that this needs to be decided on a case-to case basis, where specific circumstances can show that the competition has been weakened.⁷⁶ Indeed, the Court has stated that competitive measures which may not normally be regarded as abusive and may even be seen as desirable in some circumstances, could nevertheless be found to be in breach of Art. 102 TFEU if it has an anti-competitive effect on the market.⁷⁷ This strict approach has led to a considerable amount of criticism by scholars.⁷⁸

⁷³ Examples can be found in T-65/98 *Van den Bergh Foods Ltd v. Commission* section 157 and T-201/04 *Microsoft v. Commission* section 1070.

⁷⁴ Introduced for the first time in C 322/81 *Michelin v Commission* section 57. It is noteworthy that the special responsibility-doctrine was discussed under the dominance-requirement in this case, but has ever since been debated under the assessment of abuse.

⁷⁵ C 322/81 *Michelin v Commission* section 57.

⁷⁶ C-395/96 and C-396/96 P *Campagne belge transports v Commission* section 149.

⁷⁷ T-340/03 *France Télécom v Commission* section 186.

⁷⁸ See for instance B Sher 'The Last of Steam-Powered Trains: Modernising Article 82 (2004) *European Competition Law Review* 243, and Rafael Allendesalazar 'Can We Finally Say Farewell to the "Special Responsibility" of Dominant Companies?' *European Competition Law Annual* 2007.

To sum up, it can be argued that the traditional definition of abuse used by the EU courts is very general. This can be convenient since it offers more leeway in determining abuse on a case by case basis. On the other hand, it can be argued that the definition is *too* general, to the extent that it may be very hard to distinguish between legal and illegal behavior.⁷⁹ Based on vague, undefined parameters such as ‘performance- based competition’ and ‘competition on the merits’, and ill-defined requirements for abuse, the definition offers poor guidance when a company wishes to assess the legality or otherwise of various competitive measures.

In order to further clarify what is considered abusive misconduct, both in general and with regard to predatory pricing in particular, the case law provides some insight. In the next section the dissertation will focus on EU cases regarding predatory pricing, with an aim to establishing a clearer rule for illegal predatory pricing.

2.2. EU Predatory Pricing case law

This section takes a closer look at the EU case law related to illegal predatory pricing in breach of Article 102 (a) TFEU. The goal is to establish how the rule is enforced in practice, and to define some key factors in cases regarding predatory pricing.

2.2.1. AKZO Chemie BV v. Commission

2.2.1.1. Background and outcome of the AKZO case

One of the key decisions regarding predatory pricing in EU competition law is the AKZO case from 1991.⁸⁰ AKZO, a large, Dutch multinational firm, manufactured organic peroxides and had a market share of more than 60 per cent. ECS (Engineering and Chemical Suppliers Ltd.), on the other hand, was a small UK based company engaged in the flour segment of the market, producing benozyle peroxide. ECS’ market share had

⁷⁹ *Supra* n. 66 at 46.

⁸⁰ C- 62/86 *AKZO Chemie BV v Commission*.

been stable for around a decade, until 1979 when it gained capacity and decided to expand its business to plastic makers, some of whom were originally AKZO's customers.

Aggravated by this development, AKZO officials told ECS' manager that AKZO would take 'aggressive measures' in the ECS dominated milling products sector if ECS did not cease to supply its products to the plastics industry.⁸¹ According to the ECS' manager, AKZO officials threatened to cut prices drastically below established prices to drive ECS out of the flour market.⁸² When ECS decided not to respond to AKZO's inquiry, AKZO followed through with their threats.

During the course of the next four years, AKZO targeted ECS' customers and sold them the same products at a significantly reduced price. At the same time, AKZO charged their own loyal customers 60 per cent more than the customers targeted by ECS. As a result of this, ECS' profit margins fell and their turnover decreased by 70 per cent. ECS filed a complaint to the Commission, alleging that AKZO was engaging in predatory pricing. The Commission found AKZO guilty, and imposed a fine of ten million ECU on AKZO.⁸³

In accordance with Article 102 TFEU, the court first assessed whether AKZO held a dominant position in the relevant market. The court found that their dominance was beyond doubt in this case and all AKZO's arguments to the contrary were rejected.⁸⁴ Next, the court addressed the question of whether AKZO had abused this dominant position. The court found that prices below average variable costs – in other words costs which vary depending on the quantities produced, by means of which a dominant undertaking seeks to eliminate a competitor, must be regarded as abusive.⁸⁵

Considering the fact that selling at prices below average variable costs generated a loss for every sale, the court stated that there are no other rational explanations for a

⁸¹ *Ibid.* section 81.

⁸² *Ibid.* section 79.

⁸³ *Ibid.* section 9 to 10.

⁸⁴ *Ibid.* section 55 to 62.

⁸⁵ *Ibid.* section 71.

dominant actor to reduce prices to this level other than in an attempt to force competitors out of the market.

Moreover, the court found that prices above the company's average variable costs, but below its average *total* costs,⁸⁶ must be regarded as abusive if they are implemented as a part of a scheme to force a competitor out of the market.⁸⁷ The court's reasoning is that such prices can force out undertakings which may be as efficient as the dominant undertaking, but which, as a result of their smaller financial resources, are incapable of withstanding the competition waged against them.⁸⁸

Furthermore, the court noted the seriousness of AKZO's transgression insofar as the conduct complained of was intended to preclude a competitor from extending its activity into a market in which AKZO held a dominant position.⁸⁹ In other words, the court found that the predatory intent by AKZO was a key factor in determining the outcome of the case. Thus, the complaint from ECS was found to be substantiated, and AKZO was found guilty of abuse of dominant position in the form of predatory pricing under Article 102 TFEU. The fine was however reduced by 25 per cent to 7.5 million ECU.⁹⁰

2.2.1.2. Conclusions from the AKZO case

Based on the court's findings, the AKZO case has established the following guidelines for determining predatory pricing:

- (i) If the price is lower than the average variable costs, it is a strong indication of predatory pricing, and further investigation is deemed unnecessary;
- (ii) If the prices are higher than the average variable costs but lower than the average total costs, it must be proven that the dominant undertaking's

⁸⁶ A company's total costs refer to its fixed costs plus its variable costs.

⁸⁷ *Supra* n. 80 section 71.

⁸⁸ *Ibid.* section 72.

⁸⁹ *Ibid.* section 162.

⁹⁰ *Ibid.* section 164.

purpose or intent behind the pricing scheme is a desire to force the competitor out of the market to establish predatory pricing;

(iii) Prices above average total costs will normally not be considered predatory.

An interesting question then becomes what is meant by 'eliminatory intent'. According to the court, having eliminatory intent means that the actions were 'part of a plan for eliminating a competitor.'⁹¹ This statement suggests that the alleged predator must have had dishonourable objectives, and that its actions were motivated by an overall goal of inflicting harm on its competitors. This was found to be the case in AKZO, where the court found that the intention behind the strategy adopted by AKZO was to damage its competitor ECS, and not to pursue a general policy of favorable prices.⁹² The selective use of prices below average total costs but above average variable costs proved that AKZO intentionally targeted a specific competitor.⁹³

The test made by the court in the AKZO case, is easy enough to understand and a seemingly easy way of identifying whether the company in question has abused its dominant position by way of predatory pricing. It has, however, been argued that the AKZO test may not be a very clear cut one in all cases or industries, and that it may have limited value as a one-size-fits-all model for assessing predatory pricing. For instance, it has been contended that the AKZO test would not reflect the economic reality in some industries.⁹⁴ As an example, it could be difficult to apply the test to industries where common costs are a significant part of the total costs. These are costs which cannot be assigned to the single product or service, and as a result one cannot define one product's average cost, leaving the model from AKZO an unpractical one.

Moreover, the requirement of intent necessary to establish predatory pricing in cases where the prices used by the alleged predator are below average total costs, is difficult

⁹¹ *Ibid.* section 72.

⁹² *Ibid.* section 115.

⁹³ *Ibid.* section 113 to 115.

⁹⁴ P Lowe 'EU Competition Practice on Predatory Pricing' (5 December 2003) *Introductory address to the Seminar "Pros and Cons of Low Prices"* at 4 available at http://ec.europa.eu/competition/speeches/text/sp2003_066_en.pdf.

to reconcile with the judicial precedent stating that the concept of 'abuse' is an objective one.⁹⁵

Although the AKZO test has some critics, it has also been applied in other cases of importance in relation to predatory pricing, such as the Tetra Pak case.⁹⁶

2.2.2. *Tetra Pak International SA v. Commission*

2.2.2.1. Background of the Tetra Pak case

Tetra Pak is a company originating from Switzerland, which produces packaging machines and packaging for liquids, primarily milk. The company had a dominant position in the relevant market, with an overall market share of 78 per cent in the relevant sectors.⁹⁷ This was a share seven times bigger than its largest competitor. Tetra Pak was accused of tying⁹⁸ and predatory pricing in the Italian market. Only the latter will be examined here.

The Commission argued that Tetra Pak sold Tetra Rex cartons in Italy at a very low price in an attempt to drive out its competitors. According to the Commission, the extremely negative gross margins suffered by Tetra Pak between 1976 and 1986, together with the price differences between cartons sold in Italy and other countries of Community, left a presumption of eliminatory intent.⁹⁹

The applicant, on the other hand, argued that the prices it charged in Italy between 1976 and 1982 were not predatory, but a result of a fierce commercial competition between Tetra Pak and Elopak.¹⁰⁰ The applicant furthermore argued that there was no predatory intent behind the fact that they reduced their prices below its average variable costs, thus the reasoning of the Court in AKZO v Commission would be

⁹⁵ *Ibid.*, at 3.

⁹⁶ C-333/94 *Tetra Pak International SA v Commission*.

⁹⁷ More specifically the aseptic and non-aseptic sectors.

⁹⁸ Tying is when a company is making a customer buy one thing in order to get another.

⁹⁹ *Supra* n. 96 section 146.

¹⁰⁰ *Ibid.* section 142.

inapplicable.¹⁰¹ Moreover, Tetra Pak argued that it was not realistic that they would be able to *recoup* their losses after the alleged predatory pricing.¹⁰²

Consequently it was argued that (i) it was up to the Commission to prove an eliminatory intent, and; (ii) on the basis of the recent judgment of the Supreme Court of the United States, *Brooke Group v. Brown and Williamson Tobacco*,¹⁰³ sales at a loss can only be considered eliminatory where the company in question has a reasonable prospect of eventually recouping its incurred losses.¹⁰⁴

In its verdict, the court began by repeating the stand taken in *United Brands v. Commission*, namely that a company in a dominant position may take reasonable steps to protect its position, but that this right does not include a right to strengthen and abuse its dominant position.¹⁰⁵ Furthermore, the Court found, in accordance with the stance taken in *AKZO v. Commission*, that:

‘an undertaking in a dominant position has no interest in applying prices below average variable costs (that is to say, those which vary depending on the quantities produced) except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss equal to the total amount of the fixed costs (that is to say, those which remain constant regardless of the quantities produced) and at least part of the variable costs relating to the unit produced.’¹⁰⁶

It was thus unnecessary to discuss whether Tetra Pak had shown eliminatory intent since the company, in the years between 1976 and 1981, had reduced prices considerably below average variable costs in the relevant market. According to the

¹⁰¹ *Ibid.* section 143 referring to C- 62/86 *AKZO Chemie BV v Commission* section 71.

¹⁰² ‘Recoupment’ is when the predator regains the money lost during an often long-lasting predatory pricing scheme. The hope of recoupment is considered to be the pivotal reason for any company attempting a predatory pricing scheme.

¹⁰³ *Brooke Group v Brown & Williamson Tobacco* 509 U.S. 209 (1993). For analysis of the case see section 3.3.3. of this dissertation.

¹⁰⁴ *Supra* n. 96 section 143.

¹⁰⁵ *Ibid.* section 147.

¹⁰⁶ *Ibid.* section 148 with referrals to C- 62/86 *AKZO Chemie BV v Commission* section 72, 140 and 146.

court, there was no other rational explanation for selling products at prices this low unless it is to drive a competitor out of the market.¹⁰⁷

Regarding Tetra Pak's second key argument, namely that the possibility of recoupment had to be proven, the Court found that it was not necessary to show explicitly that Tetra Pak had a reasonable prospect of recouping its losses.¹⁰⁸ Instead, the court stressed the fact that 'it must be possible to penalize predatory pricing whenever there is a risk that competitors will be eliminated.'¹⁰⁹ Such risk was found to be present in the case, and Tetra Pak was accordingly found guilty of predatory pricing in the years 1976 to 1982.¹¹⁰

2.2.2.2. Conclusions from the Tetra Pak case

From a predatory pricing point of view, there are two important things to take from the Tetra Pak case. Firstly, the Tetra Pak case strengthened the stance taken by the Court in the AKZO case, namely that prices below average variable costs will always be considered predatory, and that prices below average total costs are predatory if there is proof of eliminatory intent. This contributed to a stronger precedence that the test is an applicable one when assessing predatory pricing in the EU.

Secondly, a new development in the Tetra Pak case was that the court stated explicitly that it was unnecessary to demonstrate the possibility of recoupment.¹¹¹ The stance taken in Tetra Pak concerning recoupment does not necessarily mean that the possibility of recoupment cannot be an important factor in a predatory pricing scheme, for instance when assessing the existence of eliminatory intent. Nevertheless, it is in conflict with the view of many economists, who firmly believe that the possibility of recoupment is the very essence and purpose of predatory pricing, and subsequently

¹⁰⁷ *Ibid.* section 148 to 150.

¹⁰⁸ *Ibid.* section 150.

¹⁰⁹ *Ibid.*, section 44.

¹¹⁰ *Ibid.* section 152.

¹¹¹ *Ibid.* section 150.

that this aspect should be given considerably more weight in the assessment of alleged predatory pricing.¹¹²

Moreover, this is in strong contrast to the findings in the US case *Brooke Group* from 1993,¹¹³ where the likelihood of recoupment had to be proven in order to be found guilty of predatory pricing.¹¹⁴ By taking this stance, the court explicitly disassociates from the way that predatory pricing was practiced in the US. The *Brook Group* case will be subject to a closer examination later in this dissertation,¹¹⁵ and a closer analysis of the approach taken by the EU will be revisited in chapter 4.

2.3. Conclusions

In conclusion, the EU has not developed, through regulations nor case law, any one-size-fits-all model for determining predatory pricing. On the contrary, establishing predatory pricing is found to be a dynamic process where the onus of proof varies depending on the market structure and the power of the company in question. The reasons for this are many, but a key reason is likely to be that it is extremely difficult to create a test which has the ability to take into consideration all the economic and structural factors that is necessary to determine whether predatory pricing is or has taken place. The advantage of this is that it gives the courts more flexibility in determining whether predatory pricing has taken place or not. A challenge, on the other hand, is that it limits the predictability for the companies, and can make it difficult for them to assess what competitive measures will be regarded as abusive.

Some guidelines are, however, provided by the case law. To be found guilty of predatory pricing in the EU, the company in question needs to hold a dominant position in the relevant market, and abuse this position by either pricing below average variable costs, or below average total costs as long as eliminatory intent is evident.

¹¹² For more about this, see chapter 5 of this dissertation.

¹¹³ *Supra* n. 103.

¹¹⁴ See section 3.3.3. of this dissertation.

¹¹⁵ Section 3.2.

In the next chapter, the focus will be on the regulation and practice of predatory pricing in the US.

3. PREDATORY PRICING IN THE US

3.1. The Sherman Act

This section will focus on the ban on predatory pricing in US competition law ('antitrust law'). The legal background for the prohibition of predatory pricing in the US is found in the Sherman Act,¹¹⁶ the Federal Trade Commission Act,¹¹⁷ and the Clayton Act as amended by the Robinson Patman Act.¹¹⁸ The most commonly used regarding predatory pricing is section 2 of the Sherman Act, which will thus be the focus of this dissertation. The provision reads in its entirety:

'Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$ 100,000,000 if a corporation, or, if any other person, \$ 1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court'.¹¹⁹

This section 2 of the Sherman Act makes illegal monopolization, or attempts thereof. The implications for being in breach of this prohibition may be severe for the company in question; in the range of multimillion dollar fines. The fundamental purpose of the provision is to protect a market-based economy that increases economic growth – or in the words of the Supreme Court:

'The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest price, the highest quality and the greatest material progress, while at the same time

¹¹⁶ The Sherman Act of 1890 15 U.S.C. section 2.

¹¹⁷ Section 5 of the Federal Trade Commission Act prohibits unfair or deceptive trade practices.

¹¹⁸ The Robinson Patman Act 15 USC § 13(a) section 3.

¹¹⁹ *Supra* n. 116.

providing an environment conducive to the preservation of our democratic political and social institutions.¹²⁰

The formulation above identifies the essence of the US antitrust goals, namely to protect the process of free competition. At the same time it acknowledges the larger political and social aspects that are served by protecting the competition process.

To ensure this goal of protecting the competition process, it has been regarded as necessary to prohibit certain types of behavior, such as unlawful monopolization as set out in the Section 2 of the Act. In short, this provision prohibits:

- (i) Willful monopolization;
- (ii) Attempted monopolization;
- (iii) Combination or conspiracy to monopolize.¹²¹

‘Monopolization’ seems to be a key term in relation to section 2 of the Sherman Act.

‘Monopolization’ can be construed to mean an attempt to attain monopoly power.

What it means to have ‘monopoly power’ is however not defined in the act, but can be construed to mean that the company in question holds a monopoly-like situation, where it has power to the extent that it can behave independently of its competitors, if any, and that it can dictate the prices in a market.

Having monopoly power is however not illegal according to the act. What is illegal is to obtain or maintain monopoly power unlawfully. It has been held that unlawful monopolization requires two key elements, the first being monopoly power, and the second the ‘willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.’¹²² Concerning the first aspect, it is natural that the monopolization refers to the company in question having monopoly power in the relevant market;¹²³

¹²⁰ *Northern Pacific Railway Co. v. United States* 356 U.S. 1, 4 (1958).

¹²¹ ABA Section of Antitrust law *Antitrust Law Developments* 6ed (2007) at 317. Number (i) and (ii) are the most frequent cases, and subsequently (iii) will not be subject to a closer analysis.

¹²² *United States v Grinnell Corp.* (1966). See also U.S. Dep’t of Justice ‘Competition and Monopoly: Single-Firm Conduct Under Section 2 Of the Sherman Act’ (2008) chapter 1.

¹²³ *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP* (2004).

however it is a requirement that this monopoly power is only unlawful if acquired by anticompetitive conduct.¹²⁴ Such anticompetitive conduct is usually described as ‘exclusionary’ or ‘predatory’ conduct, and may include conduct to obtain a monopoly unlawfully, and to maintain it unlawfully.¹²⁵

In other words, at its core, this section renders it illegal to obtain or maintain monopoly power through improper means.¹²⁶ ‘Improper means’ seems to be a key element in this regard, as attaining a monopoly through fair and legal competitive measures will not be deemed illegal. Achieving monopoly through predatory pricing is one such improper means. A line must, in other words, be drawn between ‘natural’ monopolization, where competitors have acquired a monopoly because they have a superior product, are more efficient or have lower prices, and ‘unlawful’ monopolization acquired through improper means, such as predatory pricing, cartels etc.

Secondly, section 2 of the Sherman Act also prohibits any ‘attempt to monopolize’, which includes a prohibition against attempted predatory pricing. Predatory pricing is thus illegal in the US because of the fear that it will create a monopoly for the company undertaking such pricing schemes. It must then be ascertained further what the requirements are to establish this ‘attempt to monopolize’.

According to the case law, establishing attempted monopolization requires proof ‘(1) that the respondent has embarked on a predatory pricing scheme or committed to other ‘anticompetitive conduct’ with (2) a ‘specific intent’ to monopolize and (3) has a ‘dangerous probability’ of attaining monopoly power.’¹²⁷

The term ‘anticompetitive conduct’ is vague, and the wording offers little or no guidance as to what kind of behaviour qualifies as anticompetitive. It has, however, been defined as ‘business or government practices that prevent or reduce competition

¹²⁴ *Ibid.*, at 407

¹²⁵ *Supra* n. 122. See also U.S. Dep’t of Justice ‘Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act’ (2008) chapter 1.

¹²⁶ U.S. Dep’t of Justice ‘Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act’ (2008) chapter 1.

¹²⁷ *Spectrum Sports, Inc. v. McQuillan* 506 U.S. 447, 456 (1993). See also *supra* n. 126.

in a market.’¹²⁸ In other words, anticompetitive conduct includes behaviour which has an anticompetitive or restraining effect on the competition in the market in question. Such practices or behaviour traditionally include predatory pricing, dumping, exclusive dealing, refusal to deal, tying etc.

The next question is what is meant by a ‘specific intent to monopolize’. According to case law, this entails a specific intention of destroying competition or to create a monopoly.¹²⁹ This suggests that the anticompetitive practice undertaken by the company in question must be carried out for the purpose of driving out its competitors and establishing a monopoly situation. The anticompetitive behavior is, in other words, not illegal if the objective is to compete strongly without the intent to monopolize.

Thirdly, the anticompetitive behaviour with intent to monopolize is only unlawful if there is a ‘dangerous probability’ of actually achieving monopoly power. This ‘dangerous probability’ requirement includes consideration of the relevant market, and the alleged predator’s capacity to diminish or destroy the competition in that market.¹³⁰ In other words, it must be likely that the company attempting to gain monopoly by eliminating competition actually has the ability to do so. In order to gauge whether a company has such ability, it may be necessary to carry out a market structure analysis. It is likely that only a dominant company would have the necessary strength to create a monopoly with the probable outcome of eliminating competition. The reasoning behind this approach is to prevent any constraint of the ‘vigorous and creative unilateral-business strategies’¹³¹ of smaller companies, which may arise ‘out of fear of section 2 liability.’¹³²

The seemingly strict requirements for liability under Section 2 of the Sherman Act are due to the fact that the legislators appreciated the fine line between competition-hampering monopolization and desirable, aggressive competition-promoting behavior.

¹²⁸ Definition from Wikipedia, available at http://en.wikipedia.org/wiki/Anti-competitive_practices.

¹²⁹ *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 626 (1953).

¹³⁰ *Supra* n. 126.

¹³¹ *Supra* n. 126 with referral to J Vickers ‘Market Power in Competition Cases (2006) *Eur. Competition J* 3 at 12.

¹³² *Ibid.*

Scholars have recognized that aggressive competitive conduct, even from dominant companies, has a favorable effect on the consumers, as well as the fact that aggressive exclusionary conduct is harmful to consumers. The problem, and a great challenge for the courts, is that competitive and exclusionary conduct often looks the same.¹³³

The threshold of being convicted of attempt to monopolize in accordance with Section 2 of the Sherman Act is, in other words, high. In order to ascertain how this regulation works with regard to predatory pricing in practice, it is useful to look at some cases settled by the courts. This will thus be the topic of discussion in the next section of this dissertation.

3.2. US Case Law

Predatory pricing is, in a way, a conundrum since a company is, in essence, accused of charging prices that are too low.¹³⁴ Price cutting is a competitive strategy that is beneficial to consumers and only harmful if an undertaking succeeds with a predatory pricing scheme and subsequently raises its prices. A failed predatory pricing attempt, on the other hand, is considered advantageous for consumers. To erroneously find an undertaking guilty of predatory pricing would be a disservice to competition and ultimately to the consumers, and would consequently undermine the very purpose of what Section 2 of the Sherman Act is designed to protect. A key question is therefore how to create a clear rule under section 2 of the Sherman Act that prohibits illegal predatory pricing whilst at the same time provides clear guidance to companies, competition authorities and courts.¹³⁵

To find such guidelines and establish how section 2 of the Sherman Act, and specifically predatory pricing, is implemented in practice, one needs to study the case law.

¹³³ *Supra* n. 126, with referrals to F H Easterbrook 'When Is It Worthwhile to Use Courts to Search for Exclusionary Conduct?' (2003) *Colum. Bus. L. Rev.* 345.

¹³⁴ U.S. Department of Justice, 'Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act', Chapter 4 Price Predation.

¹³⁵ *Ibid.*

Regarding US cases concerning predatory pricing, it has been said that the plaintiff has won litigated cases far too often, including cases they should have lost.¹³⁶ Along with those reasons cited earlier in this dissertation, this is one of the key issues for which the ban on predatory pricing attracts significant criticism.¹³⁷ An example is the decision in *Utah Pie Co. v. Continental Baking Co.*¹³⁸

3.2.1. *Utah Pie Co. v. Continental Banking Co.*

Utah Pie was a small, family run company producing fresh pies located in Salt Lake City. In 1957, it decided to expand its business to include the frozen pie market. In the frozen pie market, Utah Pie had to compete with three large nationwide companies, and was able to undercut its national competitors' prices since they produced their pies locally. In response, the competitors also lowered their prices. One competitor, Continental Baking Company, started selling its frozen pies in the Salt Lake City market for \$2.85, which was below-cost price, while charging higher prices for the same pies in other locations. In turn, Utah Pie reduced its price for frozen apple pies to \$2.75, a price Continental Baking Company refused to match. In 1961, Utah Pie filed suit for price discrimination.

The original ruling was in favor of Utah Pie, before the Court of Appeal reversed the decision. The Supreme Court ruled, however, in favor of the plaintiff, finding that Continental Baking Company had engaged in predatory pricing due to the fact that a jury may have 'reasonably concluded that a competitor who is forced to reduce his price to a new all-time low in a market of declining prices will in time feel the financial

¹³⁶ P Bolton et al 'Predatory Pricing: Strategic Theory and Legal Policy' (1999) at 14, available at <http://www0.gsb.columbia.edu/faculty/pbolton/PDFS/BBRPrincetonDP.pdf>. This statement concerns the outcome of cases in the decades before the *Brooke Group*-case in 1993.

¹³⁷ See chapter 5 of this dissertation.

¹³⁸ *Utah Pie Co. v Continental Baking Co* 386 U.S. 685 (1967) It should be noted that this case was decided in the context of the Robinson Patman Act of 1936 and not the Sherman Act. It is nevertheless considered representative of how predatory pricing in general was approach by the courts at the time, see U.S. Department of Justice, 'Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act', Chapter 4 Price Predation.

pinch and will be a less effective competitive force.’¹³⁹ This conclusion was reached even though Utah Pie’s sales volume steadily increased, and its financial position improved in 1958-1961, because its share in the Salt Lake City market had decreased slightly.

The ruling in *Utah Pie* received a great deal of criticism, and was claimed to be an example of a case where the courts protected competitors rather than competition.¹⁴⁰ The decision has been called the most anticompetitive decision of the decade,¹⁴¹ and it has been said that the alleged predators were found guilty not of injuring competition but simply of competing.¹⁴² A common criticism was also that the feasibility of recoupment was not weighted in the ruling. Despite the criticism, the case was not a deviation from the norm at the time as there were several cases with similar outcome.¹⁴³

3.2.2. *Matsushita Electric Industrial Co. v. Zenith Radio Corp*

Another important case regarding predatory pricing is the *Matsushita* case.¹⁴⁴ The background for this case was that Matsushita, a Japanese manufacturer of electric equipment, were allegedly conspiring to destroy the American television industry. This was purportedly done by (i) charging very high prices in Japan and (ii) using the monopoly profits from the Japanese market to subsidize the predatory prices on export sales to the US market, in an attempt to eliminate its American competitors and establishing a monopoly.

According to the plaintiff Zenith, the predatory pricing had been ongoing for two decades, and while producers like themselves would suffer economic losses in the

¹³⁹ *Ibid.* at 699.

¹⁴⁰ *Supra* n. 134.

¹⁴¹ W S Bowman ‘Restraint of Trade by the Supreme Court: The *Utah Pie* Case,’ (1967) 77 *Yale L.J.* 70 at 84.

¹⁴² *Supra* n. 134, with referral to R H Bork *The Antitrust Paradox: A Policy at War With Itself* (1978) at 387.

¹⁴³ *Supra* n. 134.

¹⁴⁴ *Matsushita Electric Industrial Co. v. Zenith Radio Corp* 475 US 574 (1986).

short run, American consumers would suffer in the long run, after monopoly had been established by their Japanese competitors.

In its ruling, the Supreme Court found that for a predatory pricing scheme to be successful, the predator must be likely to acquire a monopoly position. Secondly, the predatory pricing must cause entry barriers for potential new competitors, and thirdly the predator must be able to uphold its monopoly position for long enough to recoup its losses and eventually make profits as a result of the predatory pricing.¹⁴⁵

In this case, the Supreme Court found that the conditions for predatory pricing were not fulfilled, since the alleged predatory pricing had not caused any entry barriers for new competitors.

From the *Matsushita* case one can conclude that at least three conditions must be in place to be convicted of predatory pricing, namely:

- (i) The likelihood of attaining monopoly;
- (ii) Entry barriers for new competitors must be created from the predatory pricing strategy;
- (iii) The alleged predator must be able to uphold the monopoly for a considerable period of time, at least long enough to recoup its losses and profit by the strategy.

3.2.3. *Brooke Group Ltd v. Brown & Williamson Tobacco Corp*

Although the *Matsushita* case had provided some useful guidelines regarding the practice of the ban on predatory pricing, a more definite breakthrough after decades of uncertainties was the 1993 case of *Brooke Group v. Brown & Williamson*.¹⁴⁶ The case is regarded as a very important one. By way of background, the petitioner, Liggett, entered the cigarette market in 1980 with a line of generic cigarettes at a price 30 per cent lower than branded cigarettes. Within the next four years, Liggett managed to gain 4 per cent of the overall cigarette market at the expense of the well established

¹⁴⁵ *Ibid.*, at 589.

¹⁴⁶ *Brooke Group Ltd. V. Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993).

companies selling branded cigarettes. Aggravated by the new development, the respondent Brown & Williamson Tobacco Corp decided to introduce their own brand of low priced generic cigarettes, beating Liggett's net price. Liggett responded, resulting in a price war. According to Liggett, Brown & Williamson sold their generic cigarettes with a loss. Liggett subsequently alleged that Brown & Williamson were engaging in unlawful predatory pricing.¹⁴⁷

The complaint from Liggett was that the prices introduced by Brown & Williamson were below-cost in an attempt to force Liggett to raise its prices on generic cigarettes. This in turn allegedly restrained the economic growth in the generic cigarette market, and as a consequence preserved Brown & Williamson's supra-competitive profit margin on the branded cigarettes.¹⁴⁸

In its ruling, the Supreme Court found that in order to prove predatory pricing, the plaintiff first and foremost needs to demonstrate that the prices complained of are below an appropriate measure of its rival's costs in the short term.¹⁴⁹ Secondly, the Supreme Court held that the plaintiff needs to prove that the company accused of predatory pricing, in accordance with the Sherman Act section 2, had a 'dangerous probability' of recouping its losses from its low pricing later on.¹⁵⁰ The Supreme Court stated further that the plaintiff in such cases had to demonstrate that there was a likelihood that the alleged predatory pricing scheme undertaken by the defendant would later cause an increase in prices to an above competitive level, and that it would eventually make up for the money and resources the alleged predator had invested in it.¹⁵¹

It is thus evident from the *Brooke* case that recoupment is a key feature of predatory pricing, and that it is up to the plaintiff to prove the likely occurrence of such recoupment.

¹⁴⁷ *Ibid.* at 212.

¹⁴⁸ *Ibid.* at 212

¹⁴⁹ *Ibid.* at 222.

¹⁵⁰ *Ibid.* at 224.

¹⁵¹ *Ibid.* at 225.

Additionally, the Supreme Court also explains that evidence of below-cost prices is, in itself, not sufficient to serve as proof of probable recoupment.¹⁵² In order to determine whether there is a realistic possibility of recoupment, one has to estimate the cost of the alleged predation and do a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market.¹⁵³ In this particular case, Liggett had not done enough to prove such realistic possibility of recoupment, and the claim was consequently rejected.

From the *Brooke* case one can conclude that to prevail in a predatory pricing claim, the plaintiff must prove two things: firstly, that the prices were below an appropriate measure of defendant's costs in the short term and secondly, that the defendant had a dangerous probability of recoupment in the long run.¹⁵⁴

3.3. Conclusions

In conclusion, the US case law regarding predatory pricing underlines the importance of the possibility of recoupment. Recoupment seems to be considered the very essence of a predatory pricing strategy, for without it competition will not suffer. Consequently, unlike in the EU, it is not sufficient to prove that the company alleged to have engaged in predatory pricing has sold its products or services below average variable costs. The difference between the US approach and the EU approach will be the subject of the next section of this dissertation.

¹⁵² *Ibid.* at 225

¹⁵³ *Ibid.*

¹⁵⁴ *Supra* n. 134.

4. DIFFERENCES BETWEEN THE EU AND THE US APPROACH TO PREDATORY PRICING

4.1. Key differences

As demonstrated in the previous two chapters of this dissertation, there are indeed some noteworthy differences regarding the ban on predatory pricing in the EU and the US. The ban against predatory pricing in Article 102 TFEU in the EU requires that a company holds a dominant position in the market as a prerequisite to a finding of guilt with regard to predatory pricing.¹⁵⁵ A company with a low market share is thus allowed to take competitive measures, or compete more aggressively, than its dominant counterparts.

Such prerequisite is not explicitly stated in section 2 of the Sherman Act. In practice, however, predatory pricing is likely to be a realistic strategy only for dominant companies also in the US, as the smaller companies are very unlikely to have pockets deep enough to execute it. The focal point in the Sherman Act is to avoid monopolization through anticompetitive conduct. A predatory pricing claim in accordance with Section 2 of the Sherman Act thus requires ‘a dangerous probability of achieving monopoly power.’¹⁵⁶ A company that does not hold a dominant position in the relevant market will never be likely of attaining a monopoly, and will consequently not be found guilty of predatory pricing. It has been said that behavior which is normally compliant with antitrust law may be considered exclusionary when exercised by a monopolist.¹⁵⁷ Implicitly, dominance is therefore also a prerequisite for predatory pricing in the US.

Furthermore, to establish predatory pricing in the EU, it is sufficient that the prices applied are below average variable costs.¹⁵⁸ This has been explicitly stated in cases like *AKZO* and *Tetra Pak*, with the logic that it makes no sense for a dominant company to sell its goods or services for prices this low if not in an attempt to eliminate

¹⁵⁵ See section 2.1.1. of this dissertation.

¹⁵⁶ See section 3.1. of this dissertation.

¹⁵⁷ *Supra* n. 18.

¹⁵⁸ Ref. section 2.2.1.2.

competition. The US antitrust law, on the other hand, has no such set guidelines.¹⁵⁹ On the contrary, the US courts have found that below-cost pricing in itself was not sufficient to establish predatory pricing, without also proving a realistic possibility of recoupment.¹⁶⁰

In the EU, prices below average variable costs are presumed to be a result of predatory intent, and no further proof is necessary. Proof of intent in the EU first becomes a requirement when prices are higher than the average variable costs but lower than the average total costs.¹⁶¹ In the US, on the other hand, 'specific intent to monopolize' seems to always be a requirement.¹⁶² 'Specific intent to monopolize' is said to mean 'a specific intent to destroy competition or build a monopoly.'¹⁶³ Merely to compete vigorously to beat a rival's prices is, in other words, not sufficient to prove such intent.

As mentioned, dominant firms have however been found guilty of abusive conduct in accordance with Article 102 TFEU in cases where no such intent has been found, based on the rationale that dominant companies have a special responsibility not to distort competition.¹⁶⁴ In the EU, this burden of proof gets stricter the bigger the market share is, and in some cases the burden of proof seems not to be necessary at all. In the US, however, the proof of intent is always a requirement. This dissertation argues that proof of intent is a stricter condition, and that predatory pricing is consequently harder to prove in the US.

The most significant difference between predatory pricing in the EU and the US relates to the proof of possible recoupment. After the *Brooke* decision this seems to be a condition for a finding of guilt in relation to predatory pricing in the US. The hope, and

¹⁵⁹ Such guidelines have been suggested up to several times, the most prominent one being the Areeda-Turner test, promoting a presumption of illegality if a cost-based test is met. For further information, see for instance Areeda and Turner 'Predatory Pricing and Practices under Section 2 of the Sherman Act' (1975) 88 *Harvard Law Review* at 697. The Areeda-Turner test, albeit receiving much theoretical attention, has not taken hold in US courts.

¹⁶⁰ See section 3.2.3. of this dissertation.

¹⁶¹ See section 2.2.1.2 of this dissertation.

¹⁶² See section 3.1. of this dissertation.

¹⁶³ U.S. Department of Justice, 'Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act', Chapter 1 Introduction.

¹⁶⁴ See section 2.1.2 of this dissertation.

probability, of recoupment is, in the US, believed to be the very essence of a predatory pricing scheme; without it, a predatory pricing attempt would be futile. If dangerous probability of recoupment cannot be proven, unlawful monopoly in breach of section 2 of the Sherman Act will not occur, and competition will not be compromised – rather the opposite.¹⁶⁵ Even though probable recoupment is hard to prove, it has been stated that the requirement acts as a mechanism to limit the number of predatory pricing claims by weeding out those claims that the courts might deem questionable.¹⁶⁶

The EU does not have a similar requirement, indeed it has been explicitly stated that proof of recoupment is not necessary.¹⁶⁷ Since the probability of recoupment is very hard to prove, it can be argued that it is harder to establish predatory pricing in the US than in the EU.

Based on this, it can be concluded that there is in fact a difference between the ban of predatory pricing in the US and the EU. In the next chapter, this dissertation will focus on the reasons behind these differences, by studying competition law in general, and predatory pricing specifically, in a historical and political perspective.

4.2. Reasons for the differing treatment of predatory pricing in the EU and the US

4.2.1. Introduction

The overall objective of competition laws is to protect and promote competition in business.¹⁶⁸ This can be considered a universal objective, even though the way

¹⁶⁵ *Brooke Group Ltd. V. Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993) at 224 which states that unless recoupment is feasible, 'predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced.'

¹⁶⁶ U.S. Department of Justice, 'Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act', Chapter 4 Price Predation.

¹⁶⁷ See section 2.2.2. of this dissertation with referral to Case C-333/94 *Tetra Pak International SA v-Commission* section 150.

¹⁶⁸ O Kolstad *Norsk Konkurranserett Bind I Atferdsregler og strukturkontroll* (2007) at 25.

competition laws are implemented and practiced may vary. Competition laws are meant to provide guidance for the different actors, to ensure that their motivation is to use resources in an efficient manner. Competition is a means to strive for this overall goal of ensuring efficient use of resources.¹⁶⁹

Although the main objective of competition laws in both EU and in the US is to protect competition, and not the competitors, it can seem as if the competitors are protected to a greater extent in the EU, for instance because of the lower threshold for a predatory pricing conviction, i.e. without the necessity of proof of possible recoupment.¹⁷⁰ That EU competition authorities are willing to go particularly far in order to protect the smaller actors, was illustrated by the Commission as far back as the 1970's, when it reinforced the view of the European Parliament that a key factor for the 'smooth functioning of a modern economy' is the advancement of small and medium sized companies.¹⁷¹ Furthermore, the Commission held that it would continue to take measures with the aim of supporting small and medium-sized businesses to overcome likely difficulties and profit from the advantages which the single market can offer.¹⁷²

This focus on protecting the smaller competitors has resulted in criticism of the practice of Article 102 TFEU in recent years.¹⁷³ The reason behind much of this criticism is a desire to see a strictly economic approach to the Article 102 TFEU adopted by the authorities. The practice of this article can be contrasted with that of Article 101 TFEU,

¹⁶⁹ *Ibid.*, at 17.

¹⁷⁰ Perhaps the best example is the doctrine of the dominant company's special responsibility not to distort competition in EU competition law. The essence of this 'special responsibility' is that a company can be convicted of abuse of dominant position, even though none of the alternatives in TFEU art. 102 a)-c) apply. Dominant competitors could in other words be convicted for taking competitive measures that normally would be considered legal or even good for competition, if they could distort the market and increase the chances of a monopoly situation. See section 2.1.2. of this dissertation.

¹⁷¹ U Adolphson, 'Article 102 TFEU, Aimed at Serving the Ordoliberal Agenda or the European Consumers?' (2010) *Juridisk Fakulteten – Institutionen Uppsala Universitet* at 30.

¹⁷² *Ibid.*, at 26.

¹⁷³ For instance Sher 'The Last of Steam-Powered Trains: Modernising Article 82 (2004) *European Competition Law Review* 243, P Jebsen and R Stevens' Assumptions, Goals and Dominant Undertakings: The Regulation of Competition Under Article 86 of the European Union' (1996) *Antitrust LJ*, E M Fox Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness (1986) *61 Notre Dame L. Rev.* 981.

for example, which now allows for a much stricter economic approach. The conservative practice of Article 102 TFEU has led to the article being called ‘the last steam-powered train of the European competition system.’¹⁷⁴

This conservative approach to Article 102 TFEU can also be traced in its application in the EU predatory pricing cases. Although the overall goal of the competition laws in the US and the EU is the same, this dissertation has demonstrated that there are, in fact, differences in the way predatory pricing is practiced. To ascertain why these differences exist, it is worthwhile to examine the political and economic rationales behind the different sets of competition laws.

4.2.2. *EU Competition law in a historic perspective – ordoliberalism*

It is a well-known perception that European competition law is strongly influenced by ordoliberalism.¹⁷⁵ Ordoliberalism originates from Germany, and is a particular version of European Neo-Liberal thought, which acknowledges the value of an economy based on freedom of economic transactions and recognises the necessity of judicial oversight in economic policy-making.¹⁷⁶

Some argue that ordoliberal thought was of ‘enormous’ importance in the EU,¹⁷⁷ and especially so within the area of competition law. In the US, on the other hand, it remained virtually unknown.¹⁷⁸ A key thought in ordoliberalism is that economic freedom is the source not only of prosperity, but also of political freedom.¹⁷⁹ It was believed that if the economy was allowed to develop without governmental

¹⁷⁴ B Sher ‘The Last of Steam-Powered Trains: Modernising Article 82 (2004) *European Competition Law Review* 243.

¹⁷⁵ See for instance U Adolphson, ‘Article 102 TFEU, Aimed at Serving the Ordoliberal Agenda or the European Consumers?’ (2010) *Juridisk Fakulteten – Institutionen Uppsala Universitet*, D J Gerber ‘Competition Law and International Trade: The European Union and the Neo-Liberal Factor’ (1995) *Pacific Rim Law and Policy Journal* 37.

¹⁷⁶ D J Gerber ‘Competition Law and International Trade: The European Union and the Neo-Liberal Factor’ (1995) *Pacific Rim Law and Policy Journal* 37 at 37.

¹⁷⁷ *Ibid.*, at 39.

¹⁷⁸ *Ibid.*, at 39.

¹⁷⁹ *Supra* n. 171 at 14.

interference, growth would be secured. The pursuit of economic freedom in this regard also entails political freedom, and the desire to prevent a government or a dictator taking control over the industry.¹⁸⁰

An economy completely free of governmental involvement could however eventually allow the establishment of cartels and monopolies. This would be contrary to the ordoliberalism's perception of economic freedom, since economic freedom from an ordoliberalistic perspective is a *positive* freedom, i.e. that all citizens should have the opportunity to enter and compete in the market. Cartels and monopolies would prevent this opportunity. The solution was thus to find a balance between economic freedom and governmental interference. The state would in this way be a guarantor of fair competition. This goal, protection of the competitive process, necessarily entailed the protection of smaller competitors in the market, and was prioritized at the expense of other goals, including economic freedom.¹⁸¹

The development of ordoliberalism must be viewed in context of the time in which it was introduced. The philosophy was developed by the German Freiburg-school in the aftermath of World War II, and was strongly influenced by a desire to ensure that a government would never again gain as much power as the totalitarian regime during the war.¹⁸²

There is little doubt that, from the very start, the EU was strongly influenced by the ordoliberalism school of thought. The EU competition law was to a large extent, a reflection of the approach adopted in Germany with the main focus on securing fair competition, and individual and political freedom.¹⁸³ Today, traces of ordoliberalism

¹⁸⁰ *Ibid.* at 14.

¹⁸¹ This paragraph is based on *supra* n. 71 at 14-15.

¹⁸² Although the movement began during 1920's and 1930s, it was recognized first and foremost after World War II.

¹⁸³ D J Gerber 'Constitutionalizing the economy: German Neo-Liberalism, Competition Law and the "New" Europe (1994) *American Journal of Comparative Law*, vol. 42 at 69 to 84. Gerber seems to assume with certainty that European competition law and especially Article 102 TFEU is strongly influenced by ordoliberalism, and this seems to be the general view also among other writers. As Adolphson (at 21 onwards) points out has this view however recently been challenged by Akman, who, based on among other the *Spaak*- report, claims that the influence of ordoliberalism was not as strong as previously

can be found in Article 102 TFEU, perhaps most discernibly in the doctrine of dominant companies' special responsibility not to distort competition. This doctrine reduces the dominant companies' right to compete vigorously, as long as it may lead to a negative impact on the competition in the relevant market.¹⁸⁴ This train of thought can be traced also in the EU practice of predatory pricing, as seen in chapter 2 above. This dissertation thus argues that the way the predatory pricing ban is practiced in the EU, where the smaller competitors are favoured, can be directly traced to the ordoliberalism.

Taking into consideration the political chaos in Europe in the aftermath of World War II, it is not difficult to understand the reasons behind the development of ordoliberalism, and the implementation of its ideas into their laws and politics. Some critics have however argued that the very foundation upon which this ideology is based is outdated, and that the ordoliberalistic way of practicing Article 102 TFEU in general should be abolished for a stricter economic approach.¹⁸⁵

This dissertation submits that, despite these criticisms, the article is still practiced in this manner due to a principle referred to as 'the single market imperative'.¹⁸⁶ The single market imperative is related to the European Union's overall goal of developing a single integrated market. Competition law is strongly influenced by politics, and within the EU there are many different countries' needs and ideas to be addressed. It has been claimed that:

'a unification of the single market is an obsession of the Community authorities; this has meant that decisions have sometimes been taken prohibiting behavior which a competition authority elsewhere, unconcerned with single market considerations, would not have reached.'¹⁸⁷

thought. This issue falls however outside the scope of this dissertation, and the traditional perception will therefore be assumed in this dissertation.

¹⁸⁴ See section 2.1.2. of this dissertation.

¹⁸⁵ Sher, B., *The Last of the Steam-Powered Trains: Modernising Article 82*.

¹⁸⁶ R Whish *Competition Law* 5ed (2003) at 20 to 21.

¹⁸⁷ *Ibid.* at 21.

In order not to step on any toes, and to ensure that different actors from different countries will have the opportunity to compete in the single market, the authorities seems to be willing to go further to protect smaller actors than in other jurisdictions.

To further put this in perspective, it can be valuable to assess the US competition law's economic and political influences. US competition law is, in many ways, an opposite of EU competition law, and the next section of this dissertation will, focus on how the US justifies their system of practicing the ban against predatory pricing.

4.2.3. *US competition law in a historic perspective – Chicago School*

As previously stated, the American approach to the ban against predatory pricing, and towards anticompetitive conduct in general, seems to have a higher threshold than in the EU.¹⁸⁸ The almost *per se* prohibition of certain behavior in the EU, is not to be found in the US. Nevertheless, the notion that dominant companies are under more scrutiny than non-dominant companies, seems to be a fairly common understanding also in the US. This can be read, for instance, in the Supreme Court's decision in *Kodak Co*, where it was held that that special consideration is required when the defendant in question holds 'substantial market power'. The behaviour of such defendants may be viewed as anticompetitive simply due to their monopoly-like position. In other words, the same behaviour, when attributed to defendants with less market power, may attract little interest from antitrust laws and indeed, may be regarded as furthering competition.¹⁸⁹ Furthermore, American courts have held that 'behavior that otherwise may comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist.'¹⁹⁰ Additionally, it has been noted that due to the lack of market constraints on the behaviour of a monopolist, it will not be afforded the same level of freedom of action enjoyed by a company in a competitive market.'¹⁹¹

¹⁸⁸ See section 4.1. of this dissertation.

¹⁸⁹ *Kodak Co. v. Image Tech. Serves.* 504 U.S. 451, 488 (1992).

¹⁹⁰ *United States v. Dentsply Int'l, Inc.* 399 F.3d 181, 187 (2005).

¹⁹¹ *LePage's Inc. v. 3M*, 324 F. 3d 1441, 151-2 (2003).

From these cases, one can deduce that the freedom of action of dominant companies is narrower also in American competition law. This must be viewed in accordance with the prohibition of the 'attempt to monopolize' in paragraph 2 of the Sherman Act. Because of the detrimental effect the actions of a dominant company may have, there is an opening for the courts to interfere if the action in question could lead to a monopoly situation.

It is however hard to ascertain to what extent this rule is used in US competition law. Everything suggests that this rule is a lot narrower in the US than in the EU. This must be seen in conjunction with the fact that US courts in general are reluctant to interfere in competition and that there is a very high threshold of proof regarding attempted monopolization. Contrary to the practice in the EU, a mere theoretical possibility of reduced competition is not sufficient for the courts to interfere. This is also the case with predatory pricing, where hard evidence of likely recoupment is required.¹⁹²

While the hands-on approach undertaken by the EU courts can be explained at least partly by its roots in ordoliberalism, US competition law, 'antitrust law', must be seen in accordance with capitalism and the ideas of the free market. From a competition law point of view, an important source of inspiration is the Chicago school of thought. This thinking was developed by a group of economists and lawyers, associated with the University of Chicago, who promoted the idea that certain actions commonly considered to be anticompetitive, could actually promote competition.¹⁹³ The Chicago school is known for promoting the free market, and encouraging the desire of minimal government interference. The idea was that competition law should reflect the economic model, which involves a Darwinian approach; only the strongest and most efficient companies should survive, and it is not the State's job to protect the weak

¹⁹² See elaboration in chapter 3 of this dissertation.

¹⁹³ H Hovenkamp 'Antitrust Policy after Chicago' (1985) *Michigan Law Review* 84 (2) at 213 to 284.

competitors. The U.S. Supreme Court is said to have applied a Chicago school approach in several recent decisions.¹⁹⁴

4.2.4. *Conclusions*

Although this was a rather summarized and simplistic account of the background to the way competition laws are practiced, it is sufficient to illustrate that the ban on predatory pricing (and other forms of anticompetitive conduct) in Article 102 TFEU and Section 2 of the Sherman Act respectively, can be directly traced to the historical influences in each jurisdiction. With regard to predatory pricing, the difference is first and foremost related to the requirement of recoupment, which is a necessary condition for a finding of guilt in relation to predatory pricing in the US. This can be directly traced to the Chicago school of thought and capitalist-based approach to competition law; governmental interference should be minimal, and direct interference should only happen if there is concrete evidence that the absence of such interference will weaken competition and increase the likelihood of a monopolistic situation in the market.

A reason for the hands on approach to the ban against predatory pricing in the EU, and the less strict burden of proof for such pricing schemes, is the ordoliberalist influences coupled with the single market imperative existing in the EU. Being a coalition of many different nations who all expect to compete in the single market, which is one of the fundamental overall goals of the EU, it could be argued that the EU has a stronger incentive to prevent companies becoming too dominant in a given market, and sees it necessary to implement a more hands-on approach when it comes to regulation of the market. This is not an issue in the US, and the US government can thus allow a higher threshold before such interference is deemed necessary.

¹⁹⁴ According to Wikipedia.com, which refers to *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, (1977), *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979), *National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla.*, 468 U.S. 85 (1984), *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993), *State Oil Co. v. Khan*, 522 U.S. 3 (1997), *Verizon v. Trinko*, 540 U.S. 398 (2004), *Leegin Creative Leather Products Inc. v. PSKS Inc.*, 551 U.S. (2004). Available at http://en.wikipedia.org/wiki/Competition_law cite_note-53.

Keeping in mind that competition law throughout the world is more often than not inspired by one of these approaches, it can be interesting to ascertain what the motives are for their choice of laws. Chapter 6 of this dissertation will consequently look to South African competition law, and how it is practiced there.

It should not go unmentioned, however, that the ban on predatory pricing is a highly contested one. Due to the fact that all of the features are necessary to succeed with a predatory pricing arrangement, critics argue that the chances of profiting from a predatory pricing scheme are virtually non-existent. It is worth examining the reasons for this widespread criticism. Thus the most common criticism of the regulation of predatory pricing will be studied in the next section.

5. CRITICISM OF THE BAN ON PREDATORY PRICING

5.1. Introduction

Although many jurisdictions have regulations to prevent predatory pricing, this ban has not been uncontested and is considered highly controversial among some scholars, especially economists.¹⁹⁵ Even though criticism of the regulation of predatory pricing is not a new trend, it seems to have increased in strength in recent decades, introduced by McGee in 1958.¹⁹⁶ As will be demonstrated in this chapter, common criticism of a predatory pricing ban is that predatory pricing is an irrational pricing strategy, because of the unlikelihood of the predator ever being able to recoup its losses after selling under cost price. Furthermore, endeavouring to drive competitors out of the market by a predatory pricing attempt would be futile because of the number of predatory counterstrategies available to the companies subject to attempted predatory pricing

¹⁹⁵ See for instance J McGee 'Predatory Price Cutting: The Standard Oil (N.J.) Case' (1958) *Journal of Law and Economics* vol. 1 at 137 to 169, H Demsetz 'Barriers to Entry' (1982) *American Economic Review* 72, F Easterbrook 'Predatory Strategies and Counterstrategies' (1981) *University of Chicago Law Review* 48, T J DiLorenzo, 'The Myth of Predatory Pricing' (1992) *Cato Policy Analysis* No. 169.

¹⁹⁶ J McGee 'Predatory Price Cutting: The Standard Oil (N.J.) Case' (1958) *Journal of Law and Economics* vol. 1.

schemes. Consequently, banning such behaviour is considered by some to be a fruitless exercise as a situation where it is needed will never, or extremely rarely, arise.

This section aims to summarize the most common criticism of the ban on predatory pricing, and the rationale behind this criticism. It should be noted that much of this criticism is promoted by US economists in relation to the Sherman Act Section 2, dated before the important *Brooke* case from 1993. It is however believed that much of this criticism is still relevant today, and would be applicable also for the EU practice of predatory pricing.¹⁹⁷

5.2. Common criticism

McGee is said to be the first economist to think through the logic of predatory pricing when analyzing the *Standard Oil* case of 1911.¹⁹⁸ McGee claimed that *Standard Oil* did not engage in any predatory pricing and indeed that it would be irrational for any business to attempt to monopolize a market through predatory pricing. DiLorenzo embraces McGee's sentiment,¹⁹⁹ and claims predatory pricing is an irrational strategy for several reasons, including the following:

Firstly, predatory pricing strategies are very pricey for those companies attempting to undertake it, because the largest company will suffer the largest losses by virtue of having the largest volume of sales. Losing a dollar on each one thousand items sold is much more costly than losing a dollar on each one hundred items sold.²⁰⁰ Secondly, it is very hard to predict the duration of a price war. A long lasting price war will be very expensive and to recoup losses will prove difficult, rendering predatory pricing an extremely risky business.²⁰¹ Thirdly, the competitors subject to predatory pricing could decide to temporarily shut down and wait for the price to return to profitable levels,

¹⁹⁷ Ref. *Brooke Group Ltd v. Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993) where the bar for proving predatory pricing was raised significantly because of the recoupment-requirement. See also section 3.3.3. of this dissertation.

¹⁹⁸ *Supra* n. 196.

¹⁹⁹ T J DiLorenzo, 'The Myth of Predatory Pricing' (1992) *Cato Policy Analysis* No. 169 at 2.

²⁰⁰ *Ibid.*

²⁰¹ *Ibid.*

leaving the predator with only losses. Alternatively, if the company subject to predatory pricing should go bankrupt, other companies may buy their facilities, often at below market price, and take up competition against the predator.²⁰² A fourth reason predatory pricing is claimed to be an irrational strategy according to DiLorenzo concerns the risk that the price war will spread to adjacent markets. This can cause the alleged predator's loss to extend to markets not originally the subject of the predatory pricing scheme.²⁰³ The biggest loser in a predatory pricing scheme would consequently be the predator itself, and a ban on such behaviour would be pointless.

In addition to the reasons mentioned above, predatory pricing is claimed to be a futile strategy, and the ban unnecessary, because there are several predatory counterstrategies available to the company who is the subject of the scheme.²⁰⁴

Further justifying the notion that predatory pricing is an irrational strategy, and a predatory pricing ban futile, is the fact that regardless of hundreds of cases based on predatory pricing claims, economists and legal scholars have still not been able to prove the creation of a monopoly through a predatory pricing scheme.²⁰⁵ The US Supreme Court has also noted that 'the success of such schemes is inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition',²⁰⁶ and admitted further that 'there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful.'²⁰⁷

DiLorenzo concludes his article by stating that the ban on predatory pricing is simply illogical, since there is no proof of monopolies being created through predatory pricing schemes, and that it can only be proven through very theoretical economic models that

²⁰² *Ibid* at 3.

²⁰³ *Ibid*.

²⁰⁴ F Easterbrook 'Predatory Strategies and Counterstrategies' (1981) *University of Chicago Law Review* 48 at 334. These strategies fall outside the scope of this paper and will not be studied in detail.

²⁰⁵ *Supra* n. 200 at 5. See also R H Koller 'The Myth of Predatory Pricing: An Empirical Study' (1971) *Antitrust Law and Economics Review* 4 where Koller found no evidence of any monopoly having been established in America by predatory pricing between 1890 and 1970.

²⁰⁶ *Matsushita Electric Industrial Co. v. Zenith Radio* 475 U.S. 590 at 589.

²⁰⁷ *Ibid*.

will never occur in real life. A ban on predatory pricing will in DiLorenzo's view thus only eliminate competitive pricing.²⁰⁸

As noted earlier, a particularly challenging aspect of predatory pricing is that it can be hard to distinguish from desirable competitive conduct promoting competition and enhancing consumer welfare. It has been stated that:

'[f]rom an antitrust perspective, predatory pricing is a particularly difficult problem with which to deal. If we are to prevent anticompetitive monopolization, it is a strategy that must not be permitted. The paradox however, is that such pricing is virtually indistinguishable from the very sort of aggressive competitive pricing we wish to encourage.'²⁰⁹

A failed attempt at predatory pricing could thus be good for competition and could enhance consumer welfare.

Moreover, it has also been argued that the laws against predatory pricing might be in conflict with fundamental legal values. For instance it has been held that 'the accused must defend himself, not against actual evidence of wrongdoing, but against a theory which predicts wrongdoing in the future.' It can be likened to the criminal law notion of 'preventive detection... punishment without proof.'²¹⁰

5.3. Why is the ban against predatory pricing still practiced?

Even though criticism of the ban on predatory pricing is seemingly widespread, it remains in place in EU and the US, and most other competition law jurisdictions influenced by either the EU or the US. There are several conspiracy-like theories as to why this is so: firstly predatory pricing litigation is very expensive, which leaves, for instance, professionals involved in competition law litigation in favor of the ban;²¹¹ The

²⁰⁸ *Supra* n. 200 at 11, with referrals to H Demsetz 'Barriers to Entry' (1982) *American Economic Review* 72 and R M Isaac and V L Smith 'In Search of Predatory Pricing' (1985) *Journal of Political Economy*.

²⁰⁹ D L Kaserman and J W Mayo *Government and Business: The Economics of Antitrust and Regulation* (1995) at 128.

²¹⁰ T Sowell 'Predatory Prosecution' available at <http://www.forbes.com/forbes/1999/0503/6309089a.html>.

²¹¹ *Supra* n. 200 at 1.

average cost of litigating a predatory pricing case is claimed to be around \$30 million.²¹² Other theories suggest that predatory pricing is lobbied by ideological anti-business pressure groups, such as Citizen Action, to discredit capitalism, or protectionist groups wanting to protect US businesses from foreign companies attempting to establish themselves in the US.²¹³ Furthermore, predatory pricing is claimed to be a convenient weapon for companies who do not want to match the competitor's price cutting.²¹⁴ It has also been argued that many of the defendants tend to plead guilty simply because it is cheaper than long lasting trials.²¹⁵

Despite this apparent extensive criticism, the EU and the US still enforce a ban on predatory pricing. Furthermore, 'new' competition law jurisdictions customarily include predatory pricing elements in their legislation against illegal pricing strategies. An example is South Africa in its new Competition Act.²¹⁶ The following section will focus on the ban on predatory pricing in South Africa, how it is practiced and what the influences are for their choice of law.

6. PREDATORY PRICING IN SOUTH AFRICA

6.1. The Competition Act

Although South Africa has previously regulated competition through the Maintenance and Promotion of Competition Act,²¹⁷ it is considered to have had little impact and was strongly influenced by the apartheid-policies.²¹⁸ Consequently, South Africa serves as an example of a country with relatively new, modern competition laws, namely the Competition Act of 1998.²¹⁹ Like in most modern competition legislation, abuse of

²¹² *Ibid.*, which refers to Easterbrook 'Predatory Strategies and Counterstrategies'(1981) *University of Chicago Law Review* 48 at 334.

²¹³ *Supra* n. 199 at 1 to 2.

²¹⁴ *Supra* n. 199 at 2.

²¹⁵ *Supra* n. 199 at 6.

²¹⁶ Act No. 89, 1998.

²¹⁷ Act No. 96 of 1979.

²¹⁸ N Mackenzie 'Are South Africa's Predatory Pricing Rules Suitable?' (2012) at 10.

²¹⁹ Act No. 89, 1998.

dominance, and thereunder predatory pricing, is prohibited.²²⁰ Since the Act is relatively new, predatory pricing has not yet been properly tested.²²¹ The Act itself is thus the most important source of information. The relevant parts of section 8 read:

‘It is prohibited for a dominant *firm* to –

...

- (c) engage in an exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive, gain; or
- (d) engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive, gains which outweigh the anti-competitive effect of its act:

...

- (iv) selling goods or services below their marginal or average variable cost;’

6.1.1. Section 8(d) (iv)

Of relevance to predatory pricing is section (d)(iv), which prohibits a dominant firm ‘selling goods or services below their marginal or average variable cost.’ This prohibition is however only valid as long as it has an anti-competitive effect which is not outweighed by ‘technological, efficiency or other pro-competitive, gains which outweigh the anti-competitive effect...’²²²

The Act then specifies explicitly that prices lower than its average variable costs may imply predatory pricing. This does not however mean that a company pricing below average variable costs are in breach of the provision; the cost indicator is merely a benchmark in order to decide which types of pricing warrant closer inspection, and a potential penalty.²²³

The explicit reference to the cost-test in the Act is in contrast to both Article 102 TFEU in the EU and section 2 of the Sherman Act. Its inclusion, however, is said to bring with it possible challenges, since developments in international practice which would be

²²⁰ Section 8.

²²¹ See elaboration in section 6.2. of this dissertation.

²²² Section 8(d).

²²³ *Supra* n. 218 at 12.

desirable for South Africa would require the Competition Act to be amended accordingly.²²⁴

From the wording of section 8 (d)(iv), it appears to advocate an effect-based approach where any company selling at below average variable costs automatically undergoes scrutiny, without any question of intent. If prices are below average variable costs, there seems, like under EU competition law,²²⁵ to be a presumption of predatory intent.

Moreover, there is nothing in section 8(d)(iv) regarding proof of recoupment. It has however been stated by the Competition Tribunal²²⁶ in the matter between Nationwide Airlines and South African Airways that:

‘We would prefer not to insist on recoupment as a requirement as do the U.S. courts. For instance a firm operating in multimarkets may use predation as a form of investment in a reputation for being a tough competitor. Thus a predation strategy in market A would send a message to its competitors not only in market A, but also in markets C, D and E. Predation here has a broader strategic value beyond any recoupment it may attain in market A.’²²⁷

Proof of recoupment is, in other words, not a requirement in South African competition law. Practices listed under section 8(d)(iv) are consequently *per se* anti-competitive. This does not mean, however, that there is a conclusive presumption of illegality if prices are below average variable cost; it simply means that prices at this level are subject to closer scrutiny.²²⁸ In other words, the effects of the cost undergo an initial study, after which, if found to be anti-competitive, the company alleged to have participated in predatory pricing may be liable to a penalty.²²⁹

²²⁴ *Supra* n. 218 at 2.

²²⁵ See Chapter 2 of this dissertation.

²²⁶ The legal instance deciding competition cases in South Africa.

²²⁷ *Nationwide Airlines v South African Airways*, case 92/IR/Oct00.

²²⁸ *Supra* n. 218 at 12.

²²⁹ *Supra* n. 218 at 12.

6.1.2. Section 8(c)

Section 8(c) forbids 'exclusionary acts' other than those listed in section 8(d) 'if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive, gain.' An 'exclusionary act' is defined as 'an act that impedes or prevents a firm entering into, or expanding within, a market.'²³⁰ This is a very general definition, which can encompass many types of anticompetitive behaviour.

The flexible nature of the wording in section 8(c) renders it a one-size-fits-all approach to exclusionary conduct. The essential difference, however, is that the complainant in section 8(c) cases needs to establish that the anti-competitive conduct 'outweighs the technological, efficiency or other pro-competitive gain.'²³¹ The burden of proof must thus be considered to be higher than under section 8(d)(iv). The flip side is that the complainant is not bound by the prescribed cost formula under 8(d)(iv), provided that additional evidence of predatory pricing beyond cost is required.²³² The type of evidence that this may encompass is undefined, but the South African Competition Tribunal has in the case *Nationwide Airlines v South African Airways* stated that recoupment could be an example of such evidence.²³³

6.2. Cases regarding predatory pricing in South Africa

Although the case *Nationwide Airlines v. South African Airways* makes some useful remarks concerning predatory pricing, it is claimed not to be completely reliable as it is submitted before *Commission v. South African Airways*²³⁴ The provision has thus not been properly tested with regard to predatory pricing,²³⁵ although a predatory pricing

²³⁰ Section 1(1)(x) of the Competition Act.

²³¹ *Supra* n. 218 at 12, with referrals to P Sutherland and K Kemp 'Competition Law of South Africa' (2010) *Issue 13 Lexis Nexis* at 7 to 56.

²³² *Supra* n. 227 at 13.

²³³ *Supra* n. 227 at 13.

²³⁴ *Commission v South African Airways* case 18/CR/Mar01, see also Neil Mackenzie, *Are South Africa's Predatory Pricing Rules Suitable?* at 11.

²³⁵ N Mackenzie 'Are South Africa's Predatory Pricing Rules Suitable?' (2012) at 11.

case is pending in the Competition Tribunal.²³⁶ In this case, a predatory pricing charge was levied against Media24, for alleged predatory pricing related to the advertising rates charged by Media24 in two newspapers in the Goldfield region of Free State, in the period from 2005 until 2009.²³⁷

According to the Competition Commission,²³⁸ it found through its investigation, that Media24 had engaged in exclusionary pricing practices, by way of applying below cost advertisement prices.²³⁹ Furthermore, the Competition Commission supposedly found proof of intent; Media24's low advertising prices were allegedly part of a scheme to eliminate its competitors from the relevant market, and to strengthen Media24's status as an aggressive competitor to scare newcomers away from entering the community newspaper market.²⁴⁰ Based on this, the Competition Commission has asked the Competition Tribunal to levy Media 24 an administrative fine of 10 per cent of its turnover.²⁴¹ The case has however not yet been decided.

It is believed that the case will be instrumental in establishing guidelines for the practice of predatory pricing, and it has been noted that the Competition Commission has likely been anxious to test the new Competition Act's predatory pricing rules.²⁴²

In conclusion, the ban on predatory pricing according to the South African Competition Act is theoretically clear; prices below average variable costs undergo an effect-based examination under section 8(d)(iv). If they are found to be anti-competitive, a penalty

²³⁶ Commission Press Release, 31 October 2011 'Commission refers predatory pricing case against Media 24' referred to by N Mackenzie 'Are South Africa's Predatory Pricing Rules Suitable?' (2012) at 1. This case is not decided at the time this dissertation is written.

²³⁷ 'Media24 faces predatory pricing allegations' available at <http://mg.co.za/article/2011-11-01-media24-faces-predatory-pricing-allegations>.

²³⁸ The Competition Commission is an independent institution for competition related issues, whose authority includes gathering and carrying evidence of breach of the Competition Act. For more details regarding the structure and function of the Competition Commission, see <http://www.compcom.co.za/functions/>.

²³⁹ *Supra* n. 237.

²⁴⁰ *Supra* n. 237.

²⁴¹ *Supra* n. 237.

²⁴² See statement by C Charter, Director in the Competition and Regulatory practices at Cliffe Dekker Hofmeyr business law firm, statement to [polity.or.za](http://www.polity.org.za), available at <http://www.polity.org.za/article/media24-first-time-predatory-pricing-case-is-referred-to-the-tribunal-2011-11-04>.

may be issued. Prices above average variable costs may still be in breach of the Act, but must be considered under section 8(c). Further clarifications or specifications must follow from practice.²⁴³

6.3. Historical influences and comparison

Of great advantage to the South African legislators when drafting the new Competition Act, was that they had a vast amount of information to use as inspiration, through decades of EU and US practice. This section will undertake a short comparison of the South African Competition Act and the EU and US practices, and then go on to analyse why it is worded as it is.

The ban on predatory pricing in the South African Competition Act has several links to EU competition law and Article 102 TFEU. Firstly, average variable costs are used as a benchmark for illegal pricing, in accordance with the findings of the *AKZO* case.²⁴⁴ Furthermore, in accordance with EU competition law and in contrast to US antitrust law, proof of likely recoupment does not seem to be a prerequisite.²⁴⁵ Proof of predatory intent is not necessary under section 8(d)(iv), but is a requirement for cases under 8(c). The nature of this proof is however not yet defined, but as previously noted the probability of recoupment is likely to serve as such proof.²⁴⁶ Nevertheless, this is another contrast to US antitrust law, where specific intent to monopolize must be proven under Section 2 of the Sherman Act.²⁴⁷

In conclusion, South African competition law regarding predatory pricing is seemingly the one of the EU. Many of the reasons for this can be traced to its historical and political history. When creating competition laws, it is important to cautiously take into consideration the particular economy and society for which it is created.²⁴⁸ When

²⁴³ *Supra* n, 235 at 13.

²⁴⁴ See section 2.2.1.2. of this dissertation.

²⁴⁵ See section 4.1. of this dissertation.

²⁴⁶ *Ibid.*

²⁴⁷ *Ibid.*

²⁴⁸ *Supra* n. 235 at 3.

drafting the Competition Act, the post-apartheid South African government stated that it had to take into consideration the historical legacy of undue economic concentration and ownership, and to deal with the 'collusive practices' and economic abuse by dominant companies,²⁴⁹ and to adapt to the effects of globalization and increased international trade.²⁵⁰ It further stated that an essential feature of modern competition policy was the need to balance 'economic efficiency with socio-economic equity and development.'²⁵¹ It has been argued that a country with a history of much state ownerships and monopolies in important industries requires a more hands-on approach to protect competition.²⁵² US markets are usually prepared to deal with monopolies, and the US Supreme Court has consequently decided to intervene in competition only when strictly necessary.²⁵³

More so than in the US, it seems that the South African authorities, along with the EU authorities, have a more skeptical view of a market's ability to correct itself. This could partly account for why South African authorities chose a competition policy similar to the EU rather than that of the US.

Furthermore, it has been stated that abuse by dominant undertakings can cause a lot more damage to developing economies than to developed economies,²⁵⁴ which could also explain South Africa's approach to anticompetitive conduct such as predatory pricing.

6.4. Conclusions

South Africa is a good example of an emerging economy with new competition law inspired to a considerable extent by the EU competition law model on predatory

²⁴⁹ The Competition Commission 'about us' available at <http://www.compcom.co.za/about-us/>.

²⁵⁰ *Ibid.*

²⁵¹ *Ibid.*

²⁵² *Supra* n. 235 at 3.

²⁵³ *Supra* n. 235 at 7.

²⁵⁴ *Supra* n 35 at 3, with referrals to P Brusick and S Evenett 'Should developing countries worry about abuse of dominant power?' (2008) *Wis, L. Rev.* 269.

pricing. Like the EU, South Africa has chosen an effect-based approach where, seemingly, prices below average variable costs lead to a presumption of an intention to eliminate competitors. This does not necessarily mean that a company will be found to be in violation of section 8(d)(iv), but that it will be subject to a closer inspection. Prices above average variable costs may still be found to be predatory, however, according to section 8(c), if the complainant can prove that the alleged pricing scheme has a harmful effect on competition and is not outweighed by pro-competitive gain.

The hands-on approach to predatory pricing adopted by the Competition Act, is likely to be a result of a desire to be able to more actively steer away from monopolies and encourage the growth of small and medium-sized companies. Another reason may be the notion of the detrimental effect that abuse of dominance may have on developing economies. How predatory pricing will be practiced by the courts, however, remains to be seen.

7. CONCLUSIONS

Although a contested subject, the ban on predatory pricing still has a strong hold in modern competition law, with the EU and the US seen as the most dominating approaches. As this dissertation has demonstrated, there are some differences regarding the ban on predatory pricing in the EU and the US. One key difference is that the EU operates with a cost test, where prices below average variable costs imply a presumption of predatory pricing. The US has no such presumption, and a company is only found to be in violation of the predatory pricing ban if a likelihood of recoupment can be proven. The likelihood of recoupment is by many, especially economists, considered to be the key reason for which a company would embark on a predatory pricing scheme, and without it the strategy would be futile. The EU Court has nevertheless explicitly rejected the likelihood of recoupment as a requirement for being convicted of predatory pricing in EU competition law.

The reasons behind the choice of predatory pricing law in the respective jurisdictions, and the reasons for the above mentioned differences, can be attributed to historical, political and economic influences in that jurisdiction. The major influence behind the more hands-on approach taken by the EU can be traced to ordoliberalism, an ideology focusing on a positive freedom where everyone should have the opportunity to enter and compete in the market. Another, and closely related influence on the EU's approach, seems to be what has been called the single market imperative. Being a large union consisting of many different countries, it is desirable that companies from all countries should be able to establish themselves and compete in the common market. The US approach, on the other hand, seems to be strongly influenced by capitalism and the Chicago School thought, trademarked by as little governmental interference as possible, and only where strictly necessary. Consequently, the US has a stronger belief in the market's ability to self-correct.

Lastly, as demonstrated by this dissertation, the ban on predatory pricing in the relatively new South African Competition Act serves as an example of a jurisdiction influenced by, in this case, the EU approach. This is likely to be the case in most developing countries, because of the particularly detrimental effects abuse of dominance and monopolies can have on such countries.

Overall, a more hands-on approach such as that employed by the EU, may be more desirable, and generally better suited for developing countries as it promotes the growth of small and medium sized companies which, in turn ensures healthy competition.

BIBLIOGRAPHY

Primary Sources

Cases

South African cases

Commission v South African Airways case 18/CR/Mar01.

Nationwide Airlines v South African Airways case 92/IR/Oct00.

EU cases

Case C-6/72 *Euroemballage Corporation and Continental Can Company v Commission* [1973] ECR 223.

Case C-27/76 *United Brands v Commission* [1978].

Case C-85/76 *Hoffman-La Roche v Commission* [1979] ECR 461.

Case C-322/81 *Nederlandsche Banden Industrie Michelin v Commission* [1983] ECR 3461.

Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR I-3359.

Cases C-395/96P and C-396/96 *Compagnie Maritime Belge Transports v. Commission* [2000] ECR I-13111.

Case C 333/94 *Tetra Pak International SA v Commission* [1996] ECR I-5951.

T-65/89 *BPB Industries Plc and British Gypsum Ltd v Commission* [1993] ECR II-389.

T-229-97 *Irish Sugar v Commission* [1999] ECR II-2969.

T-65/98 *Van den Bergh Foods Ltd v. Commission* [2003] ECR II-4653.

T-219/99 *British Airways v Commission* [2003] ECR II-5917.

T-201/04 *Microsoft v Commission* [2007] ECR II-4463.

US cases

Northern Pacific Railway Co. v United States 356 U.S. 1 (1958).

United States v Grinnell Co 384 U.S. 563 (1966).

Utah Pie Co. v Continental Baking Co 386 U.S. 685 (1967).

Matsushita Electric Industrial Co. v. Zenith Radio Corp 475 U.S. 574 (1986).

Kodak Co. v. Image Tech. Serves., 504 U.S. 451 (1992).

Brooke Group v Brown & Williamson Tobacco 509 U.S. 209 (1993).

Spectrum Sports, Inc. v. McQuillan 506 U.S. 447 (1993).

Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko 540 U.S. 407 (2004).

LePage's Inc. v. 3M 324 F. 3d 1441, 151-2 (2003).

United States v Dentsply Int'l, Inc. 399 F.3d 181 (2005).

Statutes

The Sherman Anti-Trust Act of 1890 (15 U.S.C.A. §§ 1-7).

Competition Act 89 of 1998.

Article 102 Treaty on the Functioning of the European Union (TFEU) (2009).

Secondary Sources

Books

ABA Section of Antitrust law *Antitrust Law Developments* 6ed (2007) ABA Publishing, Chicago.

A Sullivan and S M Sheffrin *Economics: Principles in action* (2003) Upper Saddle River, New Jersey.

C Bellamy and G Child *European Community Law of Competition* (2001) Sweet & Maxwell, London.

D L Kaserman and J W Mayo *Government and Business: The Economics of Antitrust and Regulation* (1995) Dryden Press, Orlando.

E Osterud *Identifying Exclusionary Abuses by Dominant Undertakings under EU Competition Law, The Spectrum of Tests* (2010) Wolters Kluwer.

O Kolstad *Norsk Konkurranserett Bind I Atferdsregler og strukturkontroll* (2007) Universitetsforlaget, Oslo.

P Areeda & H Hovenkamp *Antitrust Law* 2ed (2002) Aspen Publishers.

R H Bork *The Antitrust Paradox: A Policy at War With Itself* (1978) Basic Books, New York.

R Whish *Competition Law* 5ed (2003) Lexis Nexis, London.

Articles

A Eberhard 'European Competition Law: A critical Analysis of the Process Employed by the Commission to Assess Dominance under Article 82 EC' (2006) *Hansel Law Review*.

Areeda and Turner 'Predatory Pricing and Practices under Section 2 of the Sherman Act' (1975) *88 Harvard Law Review*.

B Sher 'The Last of Steam-Powered Trains: Modernising Article 82 (2004) *European Competition Law Review* 243.

D J Gerber 'Competition Law and International Trade: The European Union and the Neo-Liberal Factor' (1995) *Pacific Rim Law and Policy Journal* 37.

D J Gerber 'Constitutionalizing the economy: German Neo-Liberalism, Competition Law and the "New" Europe (1994) *American Journal of Comparative Law*, vol. 42.

E M Fox Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness (1986) *61 Notre Dame L. Rev.* 981.

F Easterbrook 'Predatory Strategies and Counterstrategies' (1981) *University of Chicago Law Review* 48.

F Easterbrook 'When Is It Worthwhile to Use Courts to Search for Exclusionary Conduct?' (2003) *Colum. Bus. L. Rev.* 345.

H Demsetz 'Barriers to Entry' (1982) *American Economic Review* 72.

H Hovenkamp 'Antitrust Policy after Chicago' (1985) *Michigan Law Review* 84 (2).

J Kallagher & B Sher 'Rebates revisited: Anti-competitive Effects and Exclusionary Abuse under Article 82' (2004) *European Competition Law Review* 25, no. 5.

J McGee 'Predatory Price Cutting: The Standard Oil (N.J.) Case' (April 1958) *Journal of law and Economics* 1 :13760.

J Vickers 'Market Power in Competition Cases (2006) *Eur. Competition J* 3.

John McGee 'Predatory Price Cutting: The Standard Oil (N.J.) Case' (1958) *Journal of Law and Economics* vol. 1.

Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law (1997) *Official Journal of the European Communities* C 372/5.

P Bolton et al 'Predatory Pricing: Strategic Theory and Legal Policy' (1999) available at <http://www0.qsb.columbia.edu/faculty/pbolton/PDFS/BBRPrincetonDP.pdf> [last accessed on 12 September 2013].

P Brusick and S Evenett 'Should developing countries worry about abuse of dominant power?' (2008) *Wis. L. Rev.* 269.

P Jebsen and R Stevens' Assumptions, Goals and Dominant Undertakings: The Regulation of Competition Under Article 86 of the European Union' (1996) *Antitrust LJ*.

P Sutherland and K Kemp 'Competition Law of South Africa' (2010) *Issue 13 Lexis Nexis*.

R H Koller 'The Myth of Predatory Pricing: An Empirical Study' (1971) *Antitrust Law and Economics Review* 4 .

R M Isaac and V L Smith 'In Search of Predatory Pricing' (1985) *Journal of Political Economy*.

Rafael Allendesalazar 'Can We Finally Say Farewell to the "Special Responsibility" of Dominant Companies?' (2007) *European Competition Law Annual 2007*.

Sherman Act Section 2 Joint Hearing: 'Predatory Pricing' (2006) *Hr'g Tr.* 30.

T J DiLorenzo 'The Myth of Predatory Pricing' (1992) *Cato Policy Analysis* No. 169.

U Adolphson' Article 102 TFEU, Aimed at Serving the Ordoliberal Agenda or the European Consumers?' (2010) *Juridisk Fakulteten – Institutionen Uppsala Universitet*.

W S Bowman 'Restraint of Trade by the Supreme Court: The Utah Pie Case' (1967) 77 *Yale L.J.* 70.

Other sources:

C Charter, Director in the Competition and Regulatory practices at Cliffe Dekker Hofmeyr business law firm, statement to polity.or.za, available at <http://www.polity.org.za/article/media24-first-time-predatory-pricing-case-is-referred-to-the-tribunal-2011-11-04> [last accessed on 12 September 2013].

Commission Press Release, 31 October 2011 'Commission refers predatory pricing case against Media 24' available at <http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/FINAL-MEDIA-RELEASE-Media-24.pdf> [last accessed on 12 September 2013].

Director of Investigation and Research, *Predatory Pricing Enforcement Guidelines* (1992) accessed from <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01292.html>.

K Amadeo 'Monopoly' available at <http://useconomy.about.com/od/glossary/g/monopoly.htm> [accessed at 10 June 2013].

Media24 faces predatory pricing allegations' available at <http://mq.co.za/article/2011-11-01-media24-faces-predatory-pricing-allegations> [last accessed on 12 September 2013].

N Mackenzie 'Are South Africa's Predatory Pricing Rules Suitable?' (2012) at 10 available at <http://www.compcom.co.za/assets/Uploads/events/Sixth-Annual-Competition-Law-Economics-and-Policy-Conference-in-South-Africa-2012/NewFolder-5/Neil-Mackenzie-Predatory-Pricing-in-SA.pdf> [last accessed 11 September 2013].

OECD Policy Brief Competition and Barriers to Entry, available at <http://www.oecd.org/competition/37921908.pdf> [accessed 10 July 2013].

Organisation for Economic Co-operation and Development (OECD) available at <http://stats.oecd.org/glossary/detail.asp?ID=3177> [accessed on 12 September 2013].

Oxford Dictionary (8th edition).

P Lowe 'EU Competition Practice on Predatory Pricing' (5 December 2003) *Introductory address to the Seminar "Pros and Cons of Low Prices"* at 4 available at http://ec.europa.eu/competition/speeches/text/sp2003_066_en.pdf [accessed on 12 September 2013].

P Nelson 'Monopoly Power, Market Definition and the Cellophane Fallacy' *Economists Incorporated*, 1997, available at http://www.justice.gov/atr/public/hearings/single_firm/docs/222008.htm [accessed on 20 July 2013].

S Vaknin 'Competition Laws' available at <http://samvak.tripod.com/nm035.html> [accessed at 12 April 2013].

T Sowell 'Predatory Prosecution' available at <http://www.forbes.com/forbes/1999/0503/6309089a.html> [last accessed at 12 September 2012].

The Competition Commission 'about us' available at <http://www.compcom.co.za/about-us/> [last accessed on 12 September 2013].

U.S. Dep't of Justice 'Competition and Monopoly: Single-Firm Conduct Under Section 2 Of the Sherman Act' (2008) available at <http://www.justice.gov/atr/public/reports/236681.htm> [accessed 12 September 2013].